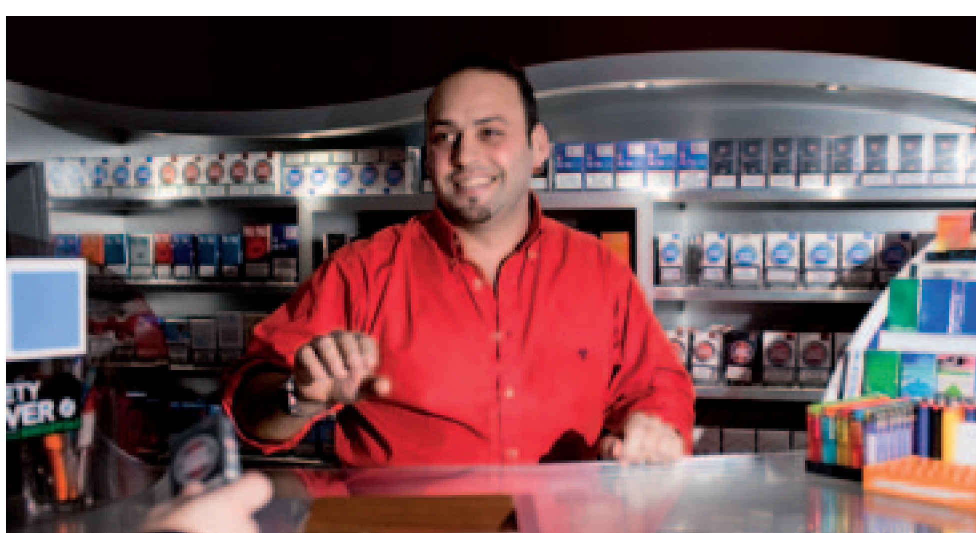
BRITISH AMERICAN TOBACCO

ANNUAL REPORT 2010

DELIVERING GROWTH THROUGH INNOVATION



2010 operating highlights

We had another very good year in 2010 and we continued to drive profit and market share growth, delivering real value for our shareholders.

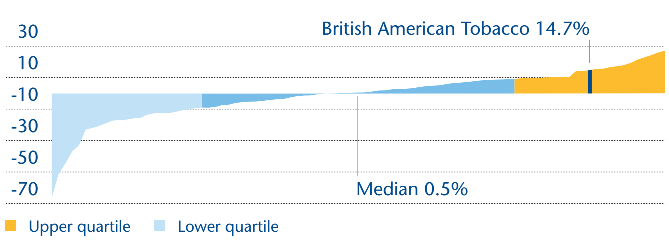
Financial highlights

Measure	Unit	2010	Change
Gross turnover (including duty, excise and other taxes)	£ million	43,855	+8%
Revenue	£ million	14,883	+5%
Organic revenue[2] at constant exchange rates	£ million	13,814	+3%
Profit from operations	£ million	4,318	+5%
Adjusted profit from operations[1]	£ million	4,984	+12%
Basic earnings per share	Pence	145.2	+6%
Adjusted diluted earnings per share[1]	Pence	175.7	+15%
Dividends per share	Pence	114.2	+15%
Free cash flow	£ million	3,240	+23%
Group cigarette volumes, excluding associates	Billion	708	-2%

Total shareholder return (annual %)

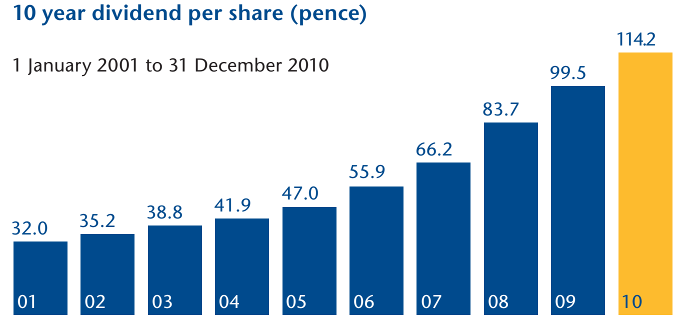
FTSE 100 – 1 January 2008 to 31 December 2010

The FTSE 100 comparison is based on three months' average values



10 year dividend per share (pence)

1 January 2001 to 31 December 2010



[1] Adjusted profit from operations is derived after excluding the adjusting items from the profit from operations. These adjusting items include restructuring and integration costs, amortisation and impairment of trademarks, goodwill impairment and gains on disposal of businesses or trademarks.

[2] Organic growth is the growth after adjusting for mergers and acquisitions and discontinued activities. Adjustments are made to current and prior year numbers, based on the 2010 Group position.

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We invest in our brands and the development of product innovations to drive growth. In 2010, this helped us increase our market share and the value of our business in our most important markets.

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Our efforts in trying to develop potentially reduced-harm products that will appeal to consumers are an important part of our R&D activities.

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We have had significant successes with innovative products such as Lucky Strike Click & Roll, Kent Convertibles and Dunhill Reloc across our regions.

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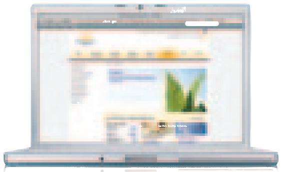
British American Tobacco p.l.c. (No. 3407697) Annual Report
This is the Annual Report of the British American Tobacco Group and the Company, comprising the Directors' report and the audited financial statements, for the year ended 31 December 2010. It has been drawn up and is presented in accordance with, and reliance upon, applicable English company law. The liabilities of the Directors in connection with this report shall be subject to the limitations and restrictions provided by such law.

The Annual Report is published on www.bat.com. A printed copy is mailed to shareholders on the UK main register who have elected to receive it. Otherwise, shareholders are notified that the Annual Report is available on the website and will, at the time of that notification, receive a short Performance Summary (which sets out an overview of the Group's performance, headline facts and figures and key dates in the Company's financial calendar) as well as a Notice of Annual General Meeting and Proxy Form.

Specific local mailing and/or notification requirements will apply to shareholders on the South African branch register.

References in this publication to 'British American Tobacco', 'we', 'us', and 'our' when denoting opinion refer to British American Tobacco p.l.c. and when denoting tobacco business activity refer to British American Tobacco Group operating companies, collectively or individually as the case may be.

More online
Detailed Company information, including the Annual Report online, the 2010 Sustainability Report and our latest results presentations can be found online at **www.bat.com/investors**



From the Chairman

> "The inherent strength of your Company's business, with its worldwide reach, its balanced portfolio of brands and its focus on innovation, continues to deliver sustained shareholder value."

Richard Burrows
Chairman

2010 highlights

- **Revenue rose to £14,883 million at current rates**
- **Adjusted profit from operations was £4,984 million at current rates**
- **Our Global Drive Brand volumes grew by 7 per cent**
- **Total dividend for the year was 114.2p, up 15 per cent on 2009**

Dear Shareholder

I am pleased to introduce the Annual Report for 2010. This has been a good year for your Company in spite of difficult trading conditions. The global economic climate has affected consumer spending in many parts of the world but the inherent strength of your Company's business, with its worldwide reach to emerging and developed markets, its balanced portfolio of brands and its consistent focus on innovation, continues to deliver impressive results and sustained shareholder value.

Strong business performance

Reported revenue rose by 5 per cent to £14,883 million at current rates, while organic revenue rose by 3 per cent at constant rates of exchange. Adjusted profit from operations increased by 6 per cent at constant rates of exchange and by 12 per cent to £4,984 million at current rates. The benefit from the translation of our results into sterling was £239 million.

This resulted in adjusted diluted earnings per share growing by 15 per cent to 175.7p.

Our regions all contributed to our very good results. However, the growth in illicit trade in a number of markets remains a cause for concern. For example, in Romania – one of our two main markets in our Eastern Europe region – our market share was up but industry volumes declined significantly due to large excise-driven price increases that led to a sharp rise in illicit trade.

Our overall Global Drive Brand volumes grew by 7 per cent in the year and we increased our overall market share in our Top 40 markets. Despite global recessionary pressures, we also improved our share of the Premium segment in these markets.

Dividends

The Board has recommended a final dividend of 81.0p per share, which will be paid on 5 May 2011 to shareholders on the register at 11 March 2011. This takes the total dividend for the year to 114.2p, an increase of 15 per cent, and maintains our target of paying out 65 per cent of sustainable earnings in dividends.

Share buy-back programme

In 2009, the Board decided to suspend the share buy-back programme that started in 2003, in order to preserve the Group's financial flexibility during a period of economic uncertainty. As a result, no shares were bought back during 2009 and 2010. The Board has approved the resumption of the programme in 2011 with a value of up to £750 million.

Board changes

During 2010, Kieran Poynter joined our Board as a Non-Executive Director. And, at our forthcoming Annual General Meeting, Ana-Maria Llopis will retire from the Board after eight years of excellent service.

At the end of February 2011, Paul Adams, our Chief Executive, retires after seven years in that role. Paul has made an immense contribution and has led your Company to a recognised position of pre-eminence in the industry.

Nicandro Durante takes over as Chief Executive on 1 March. He is very experienced in this industry and, as you will see in this report, he is committed to continuing our successful strategy and driving growth.

+15%

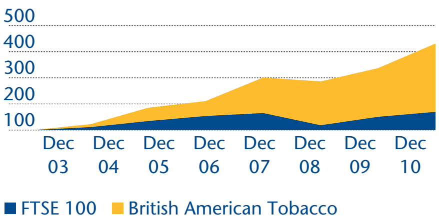
Adjusted diluted earnings per share growth for 2010

+14%

Compound growth rate over the last seven years, based on adjusted diluted earnings per share

Historical total shareholder return

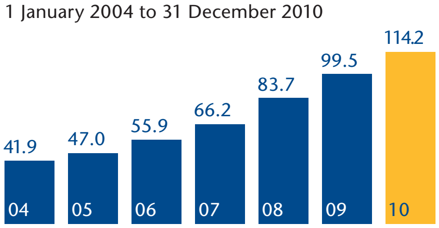
Growth in the value of a hypothetical £100 holding over seven years – FTSE comparison based on spot daily values.



Over the seven year period, the compound growth rate, based on adjusted diluted earnings per share, has been 14.2 per cent.

Seven year dividend per share (pence)

1 January 2004 to 31 December 2010



Since 2004, the dividend per share returned to shareholders has increased from 41.9p to 114.2p, an increase of 173 per cent.

John Daly has joined the Board as Chief Operating Officer and he also has a lot of experience in the industry and a very good track record.

Ben Stevens, Finance Director, has been appointed as Chief Information Officer in addition to his Finance role. This means he will have direct responsibility for the transformation of the Group as we continue to develop a more integrated approach to the management of the business.

To all our directors on the British American Tobacco p.l.c. Board and the Management Board, and to all our employees around the world, I express my thanks and appreciation for your efforts that have made this Company so successful in 2010. To Paul Adams, I say thank you and I wish you a long and happy retirement.

Excellence in sustainability

We can be justly proud of our record of excellence in sustainability, which helps us create wealth for our shareholders as well as creating value for our stakeholders.

We have long had the brands and people to deliver very good results in our key markets. During the last 10 years we have become better at demonstrating that we are running our business responsibly and we have made a number of important improvements that should ensure your Company's long-term success.

Our first Social Report was published in 2002 and this year sees our 10th publication, as our 2010 Sustainability Report is published alongside our Annual Report at the end of March for the first time.

You will see that this report features many examples of how our strategy and our approach to sustainability contribute to our growth as a business. We have also included a summary that outlines the sustainability agenda we developed in 2007 and our progress against it in 2010. You will find more detail about this progress in our full Sustainability Report online at www.bat.com/sustainability

Opportunities for growth

British American Tobacco remains in very good shape at the end of 2010. We have increased our competitiveness by growing our share in key markets and improving our cost base. There will be further global economic challenges ahead but we can see strong opportunities for growth too. That's why I am confident we can continue to deliver superior shareholder returns in 2011 and beyond.

Richard Burrows
Chairman

To see the Chairman's video introduction to this report go to:
www.bat.com/ar2010

Chief Executive's review

"In 2010 we grew market share, grew our leading international brands and achieved significant productivity savings that were well ahead of our targets."

Paul Adams
Chief Executive

A strong business in a tough marketplace
The strength of our companies worldwide and the success of our tried and tested Group strategy have enabled us to achieve very good growth through a volatile year, marked by economic uncertainty. Some emerging markets are now showing strong economic growth and even developed markets are returning to growth, yet unemployment remains stubbornly high in many parts of the world and disposable incomes are still under pressure.

So it's still a tough marketplace but our results show the true quality of our business. Our geographic diversity and strong positions in markets that have been least affected by the global recession continue to play a part in our success. However, the real story is the strength of our brands, the innovative products we bring to market and the quality of our people.

In 2010 we grew market share, we grew our leading international brands in our most important markets and we achieved significant productivity savings that were well ahead of our established targets. Our organic revenue in constant currency also rose 3 per cent, despite a decline in organic volume of 3 per cent.

Our brands are strong and growing in market share
Our brands are performing well and I believe that this shows the true vitality of the Company. Collectively, our Global Drive Brands (GDBs) – Dunhill, Kent, Lucky Strike and Pall Mall – grew by 7 per cent, reflecting the successful launch of product innovations in key markets and brand migrations.

What's pleasing is that we are growing market share where it matters most. Our overall share in our Top 40 markets grew by 30 basis points to 25.3 per cent – a really encouraging result.

Productivity enabling growth
Our structural cost base has seen big changes over the past couple of years and this will continue. This is not just belt tightening, we are reconfiguring our structural costs as a result of refining our manufacturing footprint and developing new global systems that reduce local duplication of effort and resources.

Productivity savings in the supply chain, general overheads and indirect costs amounted to £327 million in 2010 and helped us achieve an overall operating margin increase from 31.4 to 33.5 per cent. This means we have achieved our £800 million per year productivity savings target for 2012 two years ahead of schedule. I can see our ability to reduce costs continuing, especially as we exploit new global systems and processes. So we've made good progress on costs and there's more to come.

Delivering sustainable growth
Our sustainability performance is also very important to us. It's all about creating shared value – how we can create economic value in a way that also creates value for our stakeholders. The work we have done in this area, not just in 2010 but over the last decade, has been recognised through external benchmarking such as the UK's Business in the Community Corporate Responsibility Index and the Dow Jones Sustainability Indexes.

We have also received very good feedback on our Sustainability Reports and, in some cases, we have surprised independent assessors, including some who are critical of our business, with the openness and transparency of our reporting and the way we integrate sustainability with our business priorities and our strategy.

We continue to make progress on our sustainability agenda – not just our impact on the environment and our people, but also the way we conduct our operations in the marketplace and throughout our supply chain. Our focus on the consumer means that we have continued to invest in our brands and the development of product innovations to drive growth, while we also invest in the longer term to ensure the business is fit to meet future challenges. This includes having the research and development capability to support our investigation into innovative products and our efforts to develop potentially reduced-harm prototypes.

Handing over
This report marks the end of an extremely enjoyable, often challenging and always interesting seven year period for me as Chief Executive. My successor, Nicandro Durante, has much to look forward to. I know he will quickly make the role his own and his drive for success will help to ensure the continued growth of this excellent business.

I retire from the Company satisfied with the progress we have made and confident about its future. I'm clearly going to miss it. I'm tremendously proud of what we've achieved and I can only thank my colleagues in the company – all 60,000 of them – for what we've achieved together. I wish them, Nicandro and the whole business well for the future.

Paul Adams
Chief Executive

"As markets start to come out of the recession, we are now armed with a stronger portfolio and are ready to take advantage of further growth opportunities."

Nicandro Durante
Chief Executive (from 1 March 2011)

Our strategy

Our strategy is designed to deliver our vision and, as a result, build shareholder value. It is based on growth, funded by productivity and delivered by a winning organisation that acts responsibly at all times.

Our vision	To achieve leadership of the global tobacco industry.
Growth	Our strategy for growth aims to increase our market share, with a focus on our Global Drive Brands.
Productivity	Our commitment to productivity provides the resource we need to invest in our brands and grow share in our key markets, helping us to increase profit.
Winning organisation	Being a winning organisation ensures that we attract, develop and retain the people we need to deliver growth.
Responsibility	Our companies and people act responsibly at all times and we seek to reduce the harm caused by our products.

A strategy for growth

I am delighted to take on my role at a time when the opportunities for growth continue to be strong. There's no doubt that we have our work cut out to match or exceed the success of the past few years but I know that we have the right business model, the right products and the right people, with the strongest innovations anyone in our industry has at their disposal.

Our strategy certainly won't change, although we may talk about it in a slightly different way. Our business model and balanced strategy add value to all aspects of our business and we believe this sets us apart from our competitors. We still think that delivering growth is the key to achieving our vision to lead the global tobacco industry. This means placing an even greater focus on growth and ensuring that it drives everything we do. Our growth is funded by productivity and delivered by a winning organisation that acts responsibly at all times.

Strengthening our business

In 2010 we strengthened our brands, we strengthened our innovations and we increased market share. We also made good progress on our sustainability agenda and very good progress on reducing costs.

We grew share in our Top 40 markets and I believe that as markets start to come out of the recession, we are now armed with a stronger portfolio than we had before and are ready to take advantage of further growth opportunities. The key indicators are moving in the right direction, demonstrating the strength of our business.

You can read more about our strategy at:
www.bat.com/strategy

Chief Executive's review (continued)

Gross turnover
(Including duty, excise and other taxes)

£43,855 million

Revenue

£14,883 million

Our GDBs have grown 7 per cent overall in a declining total market and our share of the Adult Smokers Under 30 (ASU30) segment also increased in our Top 40 markets.

This success has been driven by innovations we have introduced across the world – such as Lucky Strike Click & Roll in the Americas and Western Europe, and Dunhill Reloc and Kent Convertibles in Asia-Pacific.

During 2010 we saw our business improve in markets that are fundamental to our growth strategy – such as Russia, South Korea, Canada, Mexico, Japan, Nigeria, the Gulf Cooperation Council countries, France and Italy. We also announced our intention to move from five to four regions to reduce complexity in our management structures, achieve a better balance in the scale of our regions and to make us more agile in our decision-making.

Global outlook

Paul has explained why we are confident we have a sustainable business, but where will the industry be in 10, 20 or even 40 years' time? Well, one thing we have always said is that it's not a good time to predict the long-term future when you're in a recession. Even so, few would disagree that the industry looks very robust for the foreseeable future. Forecasts suggest that the world market is likely to remain fairly stable at between five and six trillion cigarettes, more than 40 per cent of which are sold in China.

Even where we see volumes decline, we expect overall market values to grow due to changes in the product mix. Our consumer-led innovations will continue to help us build our premium products and the strength of our brands.

Looking at market size in isolation, we've done extrapolations that cover the next 20 years and that's where demographics become important. Trends indicate that individual smokers will consume fewer cigarettes each and smaller percentages of populations will smoke.

However, with the world's population predicted to increase to seven billion by the end of 2012 and nine billion by the end of 2050, we expect there will be a very sustainable and profitable tobacco industry delivering value for a long time to come.

The World Health Organisation has forecast that there are likely to be more smokers in the year 2050 than there are today, despite the impact of regulation. That is certainly a plausible scenario given the demographics.

Managing risks

We have identified a core list of areas that we believe could represent a significant risk to our business. As can be seen from our review of the Key Group risk factors in this report, we regularly monitor their potential impact and controls are in place to ensure that, where possible, they are carefully managed.

Competitive landscape

We are looking to grow our business and we believe we can meet our financial objectives through organic growth alone. However, we continue to monitor acquisition opportunities around the world and will participate where it makes financial and strategic sense to do so.

Illicit trade

The illicit trade in tobacco products is a growing threat to legitimate companies. We support the development of the World Health Organisation's Framework Convention on Tobacco Control (FCTC) protocol aimed at creating an international regulatory framework for addressing illicit trade. However, other measures from the FCTC may drive significant excise increases, retail display bans and plain packaging, all of which could play into the hands of organised crime by creating ideal conditions for further increases in illicit trade.

A vision for success

Looking to 2011 and the years ahead, our ambitious vision of achieving leadership of our industry remains as relevant as ever. We still have much to do to deliver our vision but our strategy for growth and our increasing competitiveness mean we are well placed to succeed.

We will continue to refresh and enhance our brand portfolio, introducing consumer-focused innovations where appropriate. Our operational fitness will also continue to improve, as we implement and roll-out new global systems. I look forward to the challenges ahead and I know our people around the world do too.

Nicandro Durante
Chief Executive (from 1 March 2011)

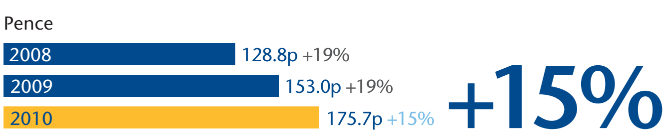
Measuring our performance

We have a wide range of measures and indicators by which the Board assesses performance compared to the Group's strategy. To ensure management's focus is aligned with the interests of our shareholders, our KPIs are reflected in our management incentive schemes. Although our other business measures are not directly included in management's incentives, we believe they improve the quality of our business and contribute to shareholder value, particularly over the long term.

Shareholder value

Key performance indicators (KPIs)

Earnings per share
This is our adjusted diluted EPS – the detail of the calculation and the adjustments made are explained in note 7 to the financial statements. Our target is to grow adjusted diluted earnings per share at the rate of high single-figures per annum, on average, over the medium to long term.

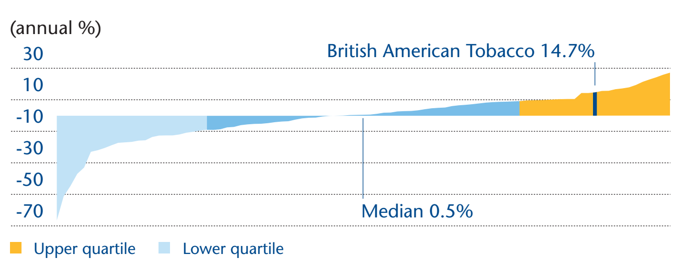


Total shareholder return – annual %
The Group's strategy is focused on increasing shareholder value, which is measured using Total Shareholder Return (TSR) compared to the FTSE 100 Index and also to the Fast Moving Consumer Goods (FMCG) peer group. The FMCG comparator group is reviewed annually to ensure that it remains both relevant and representative.

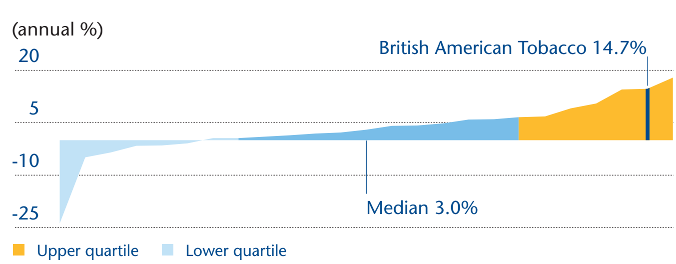
TSR is measured according to the return index calculated by Datastream, on the basis of all companies' dividends being reinvested in their shares. The return is the percentage increase in each company's index over a three year period.

The target is to show an above average performance in the long term, compared to the two comparator groups, based on a three year average.

FTSE 100 – 1 January 2008 to 31 December 2010
The FTSE 100 comparison is based on three months' average values



FMCG group – 1 January 2008 to 31 December 2010
The FMCG group comparison is based on three months' average values



Measuring our performance (continued)

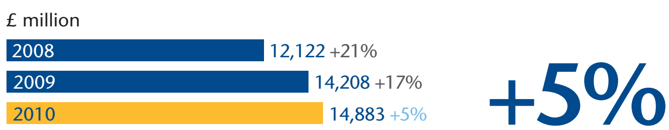
Growth

Key performance indicators (KPIs)

Revenue growth

This figure is calculated as the revenue of the Group after the deduction of any duties, excise and other taxes, as published in the Group income statement.

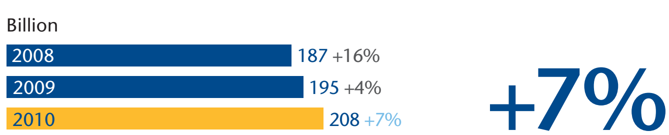
Our target is to grow revenue, on average over the medium to long term, by 3-4 per cent per annum.



Global Drive Brand (GDB) volume

GDB volumes are calculated as the total volumes of the four brands – Dunhill, Kent, Lucky Strike and Pall Mall – sold by our subsidiaries.

Our target is to achieve high single-figure growth, on average, over the long term.



Group's share of key subsidiary markets

This is our retail market share in the Group's Top 40 markets which covers around 80 per cent of the volumes of subsidiaries. The information used in this calculation is based on publicly available information and internal company analysis.

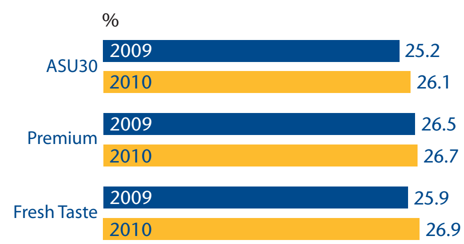
Our target is to continue to grow market share.

Business measures

Share growth in key segments

This is our overall share of volume in the Group's Top 40 markets in three key segments: Adult Smokers Under 30 (ASU30), Premium and Fresh Taste.

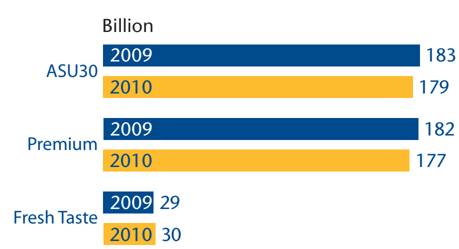
Our target is to maintain or grow our share of volume in each segment each year on an organic basis.



Strategic segment volume

This is our total volume sales in the Group's Top 40 markets in three key segments: Adult Smokers Under 30 (ASU30), Premium and Fresh Taste.

Our target is to maintain or grow total volume in each segment each year on an organic basis.



Our key strategic segments no longer include the Lights segment. Our Menthol segment has been renamed Fresh Taste and now includes Menthol and Mint, although this does not affect the reported share and volume figures for the segment and the comparisons with 2009.

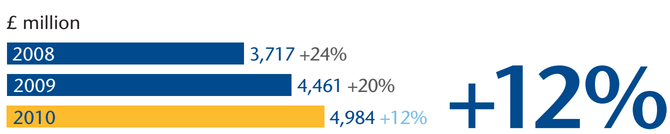
Productivity

Key performance indicators (KPIs)

Adjusted profit from operations

Profit used in this assessment is the adjusted profit from operations of the Group's subsidiaries – adjusted for the items shown as memorandum information on the Group income statement.

The Group's target is to grow adjusted profit from operations on average by 6 per cent per annum.



Overheads and productivity savings

Overheads are calculated as the total costs of all subsidiaries, less variable costs and less all marketing investment.

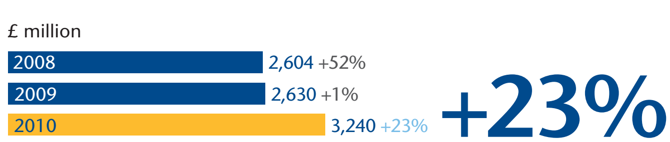
Productivity savings are the savings in supply chain, overheads and indirect costs (anything other than leaf, wrapping materials, cigarette-making machinery and labour).

A specific target is set each year to contribute to the £800 million savings target set for 2012. The £800 million target was reached in 2010, two years ahead of plan.

Cash flow – free cash flow

Free cash flow is defined as net cash from operating activities (including dividends from associates, restructuring costs and taxation) less net interest, net capital expenditure and dividends to minorities.

A specific target is set each year for free cash flow. The target for 2010 was exceeded.



Business measures

Operating margin

This is the percentage of adjusted profit from operations divided by revenue.

Our target is to increase operating margin to at least 35 per cent by 2012.

Free cash flow as a percentage of adjusted earnings

This measures our free cash flow as a ratio of the adjusted diluted earnings.

Our target is to maintain the percentage figure in the mid-80s.

Measuring our performance (continued)

Winning organisation

Business measures

'Your Voice' employee opinion survey

We collect views from employees through our 'Your Voice' survey once every two years to help us measure our progress in employee engagement.

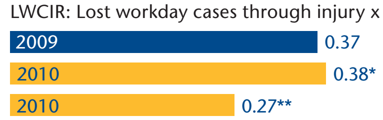
Our target is to achieve more positive scores than the other Fast Moving Consumer Goods (FMCG) companies in our comparator benchmark group in all areas. In 2010, scores in all categories were more positive than the FMCG benchmark, and we either maintained or improved on our 2008 score in eight of the 11 categories.

Lost Workday Case Incident Rate (LWCIR)

The LWCIR is a standard health and safety measure that helps us measure working days lost through injury on a consistent basis year-on-year.

Our global aim is to have an LWCIR of 0.2 by the end of 2012. The local target set for all of our companies is zero accidents.

LWCIR: Lost workday cases through injury x 200,000 ÷ total hours worked



* Excludes Indonesia
** Includes Indonesia

Responsibility*

Business measures

Dow Jones Sustainability Indexes

The Indexes track the economic, environmental and social performance of leading companies based on the integration of sustainability into their businesses.

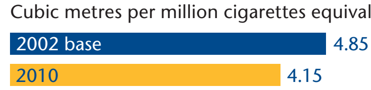
Our target is to achieve a higher score than the sector average in a minimum of 14 out of 18 categories. In 2010, we achieved a higher score in 17 categories.

Water use

This measure tracks Group water use in cubic metres per million cigarettes equivalent.

Our target is to reduce water use by 48 per cent by 2012 from our 2002 base.

Cubic metres per million cigarettes equivalent

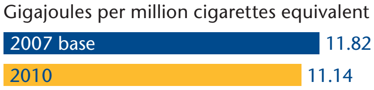


Group energy use

This measure tracks Group energy use in gigajoules per million cigarettes equivalent.

Our target is to reduce energy use by 6.7 per cent by 2012 from our 2007 base.

Gigajoules per million cigarettes equivalent

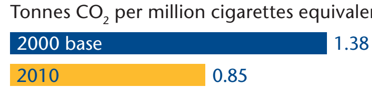


Carbon dioxide equivalent (CO_2e)

CO_2e is largely derived from energy consumption and we track this in tonnes per million cigarettes equivalent.

Our target is to reduce Group CO_2e by 50 per cent by 2030 from our 2000 base.

Tonnes CO_2 per million cigarettes equivalent



Waste to landfill

This measure tracks Group waste sent to landfill in tonnes per million cigarettes equivalent.

Our target is to reduce waste sent to landfill in tonnes per million cigarettes equivalent by 12 per cent by 2012 from our 2007 base.

Tonnes per million cigarettes equivalent

Recycling

This measure tracks the total percentage of Group waste re-used or recycled against total waste generated.

Our target is to recycle more than 85 per cent of waste generated in each year.

Percentage of waste recycled

* 2010 figures exclude performance data from our acquisition in Indonesia

For more information visit
www.bat.com/sustainability

Strategic review

Our consistent strategy for delivering our vision is based on growth, funded by productivity and delivered by a winning organisation that acts responsibly at all times.

Our strategy

Our strategy is designed to deliver our vision and, as a result, build shareholder value. It is based on growth, funded by productivity and delivered by a winning organisation that acts responsibly at all times.

Our vision
To achieve leadership of the global tobacco industry.

Growth
Our strategy for growth aims to increase our market share, with a focus on our Global Drive Brands.

Productivity
Our commitment to productivity provides the resource we need to invest in our brands and grow share in our key markets, helping us to increase profit.

Winning organisation
Being a winning organisation ensures that we attract, develop and retain the people we need to deliver growth.

Responsibility
Our companies and people act responsibly at all times and we seek to reduce the harm caused by our products.

Growth

Our business is operating in a landscape of challenging economic conditions, excise rises above inflation, increasing regulations and changing consumer behaviours. In the face of these challenges it is all the more important that we focus on achieving sustainable growth.

We have a great portfolio of brands, encompassing not only our Global Drive Brands (GDBs) and other international brands, but also strong local brands across a diverse geography. The focus of our strategy is to build our premium brands across our entire portfolio, with a focus on our GDBs, but we also seek growth in our Value-For-Money (VFM) and Low-Price segments.

Our industry-leading brand innovations were highly successful in a wide range of markets in 2010. These innovations deliver consumer value and increased market share, further driving our commercial growth and helping to move us towards attaining our vision of achieving leadership of the global tobacco industry.

Growth through innovation

Our growth in 2010 has been driven by pack and product innovations throughout many markets across our range of GDBs.

Dunhill, our most prestigious brand, continued its strong share growth in key markets in 2010, driven by the success of Reloc, the re-sealable pack exclusive to Dunhill. Good organic growth in key markets and successful brand migrations to Dunhill in Brazil and South Africa continued to confirm the brand's consumer relevance, with overall volume growing in 2010.

Kent, our most innovative brand, achieved market share growth in 2010 with the successful launch of Convertibles in South Korea, Russia, Ukraine and Turkey. Kent Convertibles feature a menthol-flavoured capsule that can be activated by the consumer to release a refreshing taste.

The capsule can be crushed at any time during the smoke, giving consumers the freedom to change their taste experience anytime.

This innovation helped strengthen the pioneering image of the brand, expanded its footprint in new markets and generated stronger momentum with consumers in the Adult Smokers Under 30 (ASU30) segment.

Lucky Strike, a brand particularly successful in the ASU30 market, launched Click & Roll in 2010 using similar technology. It was successfully launched in several markets throughout the year, including launches throughout the Americas region.

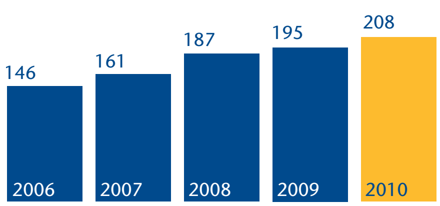
Click & Roll performed very strongly, far exceeding our own high expectations and helped to deliver 2 per cent total organic volume growth for Lucky Strike globally. Its share reached record levels in a number of key markets as a result of this innovation.

Dunhill Reloc

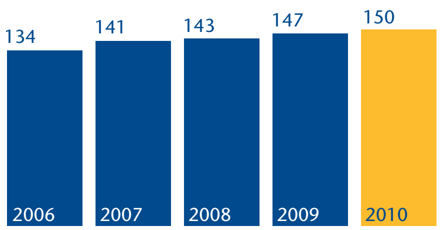
Exclusive to Dunhill, Reloc re-sealable packs helped drive brand growth in 2010 and it is now in 66 markets worldwide. Key markets to launch the new pack in 2010 included Mexico and Australia.

Strategic review (continued)

Global Drive Brand volume
Billion



Other international brand volume
Billion



Pall Mall is our key VFM brand and it delivered total volume growth of 8 per cent in 2010. This took its success to record levels, and including sales from our associates, Pall Mall is now the third largest cigarette brand in the world, excluding China.

This strong performance was achieved through significant growth in Western Europe, Pakistan and Chile, as well as a successful migration in Denmark. Driven by the product innovations of Pocket, Nanokings and Super Slims, the Pall Mall Slims category grew volume by 18 per cent in 2010 and now accounts for 9 per cent of our global Pall Mall volume.

Trade marketing and distribution

Our Trade Marketing & Distribution (TM&D) is responsible for the development of our brands and delivery of our products to retail customers, as well as engagement with retailers on issues such as youth smoking prevention.

Route to market

Our routes to market are a critical enabler of our growth strategy. They allow us to quickly roll out innovations on a global scale and to fully meet consumer demand at the point of sale. We are constantly reviewing our routes to market to ensure we remain competitive. This includes examining our relationships with wholesalers, distributors and logistics providers.

Where appropriate, we believe that direct to store sales (DSS) are the most effective way of serving retailers and building sustainable business partnerships. DSS gives us visibility and control over the sales and distribution process, allowing us greater access to both the market and consumer information. It also provides a direct commercial link to our most strategic retail accounts. Half of our volume globally is sold to retailers through our own distribution capability in key markets including Canada, Brazil, South Korea, Australia, Russia, Romania, South Africa and Nigeria.

Customer management

Building relationships with retailers makes up a large part of our trade marketing activities. We work with our retail partners to ensure that at all times they can profitably meet the expectations of adult smokers with regards to availability, pricing and brand quality.

We regularly survey our international customers and benchmark our performance across different trade channels against competitors and other blue-chip Fast Moving Consumer Goods (FMCG) companies.

The 2010 results show that half of the retailers in the 33 markets surveyed rate British American Tobacco as the best consumer goods company to do business with. When evaluating distribution specifically, almost two out of three retailers rate us as the best company they deal with. Markets surveyed included Germany, France, Italy, the UK, Belgium, Poland, Romania, Switzerland, Malaysia, Bangladesh, Vietnam, Pakistan, Canada, Chile, Colombia, South Africa, Egypt and Nigeria.

Global retail customers

We make a special effort to understand and develop joint programmes with global retail partners in order to reach adult smokers in key channels such as global travel retail and convenience.

During 2010, we received several accolades from trade organisations operating in these channels. After being nominated three times for the Frontier Awards – the travel retail industry's most prestigious awards – in 2010 British American Tobacco won the 'Star Product of the Year' category.

Productivity savings from the supply chain in 2010

£327 million

Brand growth

Including sales from our associates, Pall Mall is now the third largest cigarette brand in the world, excluding China

Dunhill grew volume by 18 per cent in 2010, following 9 per cent growth in 2009

Kent grew market share in six of its Top 10 markets during 2010

Click & Roll helped Lucky Strike achieve record market share in five key markets in 2010

Productivity

Our commitment to productivity provides the resource we need to invest in our brands and grow share in our key markets. An effective, globally-integrated supply chain is therefore critical to us as a business. Its complexity and scale, combined with the need to deliver vital business benefits, means that it will carry on evolving. We continue to build a consumer-led, customer-focused supply chain, dedicated to supporting sustainable growth. This is a key aspect of our Group strategy and we intend to further leverage the global scale of our supply chain.

Productivity savings

As a commercial business, we are focused on improving effectiveness and efficiency. The savings generated are a source of operating profit growth and cash for reinvestment in the business. Our focus is on smart cost management, marketing efficiency and capital effectiveness. This includes reducing unnecessary complexity to save costs and using our cash and assets more effectively.

Our supply chain is organised globally in a matrix of regional service centres that deliver to markets. A global centre unlocks the benefits of scale and manages centres of expertise for the benefit of the whole Group.

In 2010, productivity savings from the supply chain, including indirect material procurement and overhead savings, amounted to £327 million at constant rates of exchange. Since 2008, supply chain efficiencies have delivered over £800 million of savings, surpassing our announced savings target two years ahead of schedule. We are confident that we can continue to deliver efficiencies for the foreseeable future and hit our target operating margin of at least 35 per cent by 2012.

Optimising resource allocation

Marketing and the supply chain help deliver the growth agenda for the Group. We have established common processes and systems and now have global transparency of demand and supply. This has enabled faster decision-making on innovations, as well as more productive investment and sourcing decisions.

As a result, we have been able to optimise our cigarette production footprint. Over the last 10 years we have reduced the number of factories from 87 to 45, including acquisitions. In 2010, we ceased production in five locations: Tire in Turkey, Cirebon in Indonesia, Lecce in Italy, Jawornik in Poland and Soeborg in Denmark.

Consolidation of factories around the Group has been undertaken responsibly and with care for affected employees and local communities. It has removed much of our previous excess capacity and means that more of our factories are now serving a larger number of markets. Consequently, we have built capability in above-market planning, which has also allowed us to roll out innovations faster and implement machine technology standards – improving our capital effectiveness and sourcing flexibility.

Transforming procurement

The global transformation of procurement to an above-market model enables us to focus on delivering supplier-sourced innovation, improved internal service and better quality products. It also allows us to take advantage of scale and expertise.

Strategic review (continued)

Procurement joint venture
Our procurement joint venture with brewing company AB Inbev expanded its activities into new categories of above-market cost management including travel, fleet, HR professional services and IT. This allows us to take advantage of scale and expertise, helping us to deliver increased value from our spending.

Leaf supply chain
Leaf is critical to supporting consumer preferences for different blends and tastes. We have the most vertically integrated leaf supply chain in the industry and believe that this continues to provide a competitive advantage to us as a business. It also enhances our product portfolio and provides us with a strong position from which we can address the effects of product-based regulation.

Our current leaf-growing footprint provides long-term sustainability of supply and guaranteed access to quality sources of leaf. It also gives us the ability to manage short-term variations in pricing driven by external commodity price pressures.

Business continuity
The robustness of the above-market operating model was tried and tested in 2010 as we successfully maintained supply despite a number of significant challenges. These included port strikes in Nigeria and natural disasters around the world, such as the earthquake in Chile and floods in Pakistan and Mexico.

Supplier partnerships
As part of our philosophy to expand our supplier partnership to wider aspects of the supply chain, we built upon the strategic Framework Agreement we signed with Cranfield School of Management in 2009. Within this framework, we established cross–industry collaboration research groups and commissioned a number of long-term research studies aimed at developing a leading edge supply chain strategy.

Winning organisation

Our employees come from diverse cultures and backgrounds, and our business benefits from the breadth of ideas and experiences they bring. We aim to recognise individuality and encourage people to perform at their best.

In attracting, developing and retaining talented individuals, we have the opportunity to build a winning organisation. Having a strong and clearly differentiated reputation as an employer is therefore critical to our long-term business sustainability.

Recruitment and induction
Our employer proposition, which is based on the experiences of existing employees, was rolled out in all but one market in 2010, where we are expecting full alignment by the end of 2011.

As well as launching a Group-wide programme for new joiners that includes a standard 90-day induction plan, we conduct exit interviews for all of our losses at management level. We hope that by better understanding their reasons for leaving, we will be able to further improve our retention of key talented employees.

Learning and development
In 2010, we introduced a combination of face-to-face and online development programme for managers at global, regional and local levels. We are also developing a global training management system that gives our regions and functions a clearer view of the capability gaps in their operations.

It is our long-term aim to have succession plans in place for every senior role, with at least one local successor ready in the short term and two local successors identified for long-term development.

Diversity and equality
British American Tobacco is dedicated to providing equal opportunities to each employee. We do not discriminate when making decisions on hiring, promotion or retirement on the grounds of race, colour, gender, age, social class, religion, smoking habits, sexual orientation, politics or disability – subject to the inherent requirements of the role to be performed.

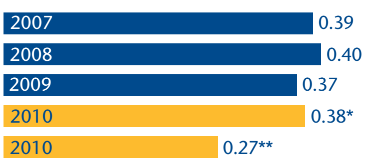
We are committed to providing training and development for people with disabilities, tailored where appropriate. If a British American Tobacco employee becomes disabled while in our employment, we will do our best to retain them and make appropriate adjustments and provisions.

We continue to support the career development of our talented female managers, with a view to increasing the number of women in senior management. This includes tracking development plans for our senior women, assigning mentors and encouraging recruitment consultancies to draw up gender-balanced shortlists of candidates when we recruit externally.

Best place to work

We won several awards around the world in 2010 for being a great place to work. This included Top Employer accolades in Ukraine and Spain, and a Best Place to Work award in Central America and the Caribbean.

Lost Workday Case Incident Rate (LWCIR)
LWCIR: Lost workday cases through injury x 200,000 ÷ total hours worked



* excludes Indonesia
** includes Indonesia

Work environment

Our environmental health & safety (EHS) policy sets out detailed requirements for all Group companies and applies across our own activities as well as our approach to managing our supply chains. It requires our companies, as well as complying with all applicable laws and regulations, to establish procedures for regularly assessing and reviewing the EHS impacts of their present and future activities. They must also identify cost-effective measures to safeguard the physical environment and the health and safety of all personnel on company premises.

The Group's Lost Workday Case Incident Rate (LWCIR) in 2010 was 0.27, an improvement on 0.37 in 2009. However, this was largely the result of the acquisition of our business in Indonesia, which significantly increased the total hours worked for the Group. Excluding Indonesia, the Group's LWCIR is 0.38 – a small increase from 2009.

The number of actual lost workdays increased to 212 compared to 206 in 2009, however, 62 per cent of our sites were accident-free in 2010.

The highest proportions of injuries were vehicle-related at 25 per cent (2009: 25 per cent), manual activity at 25 per cent (2009: 20 per cent) and slips and trips at 21 per cent (2009: 22 per cent). Entrapment accidents decreased to 9 per cent (2009: 12 per cent).

There were 29 serious accidents in 2010, involving 25 employees and four contractors. Of these, four were fatalities (three employees and one contractor), compared to three in 2009 (all employees). One was the result of a fall from height and the remaining three resulted from vehicle accidents. We greatly regret this loss of life. We systematically review every major incident to identify any ways in which we can prevent a recurrence.

Employee opinion survey

Our 'Your Voice' employee opinion survey is conducted every two years and benchmarks our performance against a comparator group of FMCG companies. The survey was conducted in 2010, with 90 per cent of employees participating.

In all 11 categories, employee opinion of British American Tobacco was more positive than the benchmark for businesses in the FMCG sector. We either maintained or improved on our 2008 scores in eight of the 11 categories.

Employee engagement

British American Tobacco is committed to employee engagement throughout the business and this includes acting on areas identified as needing improvement in our employee survey.

Employees are kept well informed of the strategy, performance and objectives of the Group through communication cascades at key points in the year, which involve video broadcasts from the Chief Executive, face-to-face presentations and Q&A discussions. Global, regional and local intranets, web-based meetings and presentations, and electronic employee magazines also provide important information, while feedback is encouraged through open forums and Q&A sessions.

All UK employees are eligible to join our Sharesave Scheme, our Partnership Share Scheme, as well as the Share Reward Scheme. In addition, senior management participate in our executive share incentive schemes. UK employees on international assignment are eligible to join the International Share Reward Scheme.

Strategic review (continued)

Responsibility

Responsibility is integral to everything we do, and is especially important to a business such as ours where our products pose real risks to health. Our determination to act responsibly spans the whole business, from our commitment to addressing the issues of child labour and working with farmers, to looking at how we can reduce the harm of our products and lessen our environmental impact.

Our Business Principles and our Standards of Business Conduct set out what we require of our companies and our employees in terms of responsible corporate behaviour and personal integrity.

We also support regulation that maintains a balance between consumer preferences and the interests of society, enabling our business to continue to compete commercially.

Harm reduction

Tobacco harm reduction involves the research, development and test-marketing of innovative tobacco products that potentially offer reduced health risks. Being the first to market with a range of reduced risk products also has advantages for commercial sustainability.

We believe we are continuing to make a significant contribution to the science needed to assess potentially reduced-exposure products. In 2010, we completed the analysis of two studies begun in Italy in 2008 and 2009. We also finished our analysis of a 2009 study of a range of prototype cigarettes designed to have lower levels of smoke toxicants than conventional cigarettes.

We continue to publish and present our scientific results whenever we can and engage with regulators.

Research and development

Our Group Research & Development (R&D) activities are concentrated on our harm reduction efforts but also encompass the exploration of new products and innovative technologies. Our Group R&D function also provides guidance on the use of ingredients to ensure our products comply with national legislative requirements and our own Group standards.

Our principal R&D facilities are located at Southampton and Cambridge in the UK and at Cachoeirinha in Brazil. In 2010, investment in Group R&D was £117 million, an increase of £5 million from 2009.

Responsible marketing

We believe that for a business such as ours, responsible marketing is paramount. This is why we voluntarily adhere to our International Marketing Standards (IMS) to give us a consistent, principled approach to marketing across the Group.

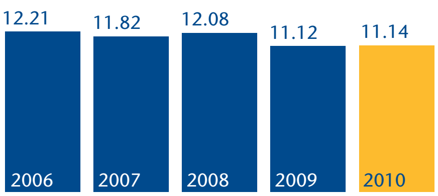
Our IMS state that marketing should be targeted at adult consumers and not be misleading about the health risks of smoking. Where local law is less stringent than our standards we adhere to our IMS.

In 2010, six companies reported instances of non-adherence to our IMS. Four of these were resolved so that by the end of 2010 all our companies except two reported full IMS adherence. This included Indonesia where the market is very lightly regulated. However, we comply with the law and we aim for full adherence with our IMS by March 2012, two years after taking control of the business.

Environmental performance

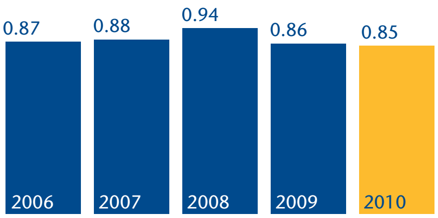
As a business with an agricultural supply chain, we depend heavily on natural resources and ecosystems. We therefore recognise the need to manage our environmental footprint in a strategic and sustainable way. It not only makes good economic and environmental sense for us to use raw materials, energy and water efficiently, it is our responsibility.

Group energy use
Gigajoules per million cigarettes equivalent



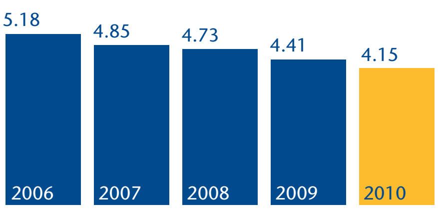
Group energy use is the energy used by the Group in its own operations, business travel and freight. We do not include energy used to produce and deliver purchased energy.

Carbon dioxide equivalent (CO_2e)
Tonnes CO_2e per million cigarettes equivalent



Group CO_2e is calculated from the energy used in Group operations, business travel and freight and incineration and landfill.

Water use
Cubic metres per million cigarettes equivalent



Research & Development expenditure in 2010

£117 million

Our key environmental issues are energy consumption, water use, waste and our wider contribution to climate change. We also endeavour to minimise any negative impacts on biodiversity.

All environmental figures quoted for 2010 exclude performance data from the Bentoel business that we took control of in Indonesia in January 2010.

Energy use

We decreased absolute energy consumption by 1.5 per cent in 2010, driven by energy reduction programmes and site rationalisation. However, Group energy use was up by 0.2 per cent from 2009, to 11.14 gigajoules per million cigarettes equivalent produced. This was mainly due to a decline in volume.

Carbon dioxide equivalent (CO_2e)

Group CO_2e was down in 2010 by 1.2 per cent from 2009 to 0.85 tonnes per million cigarettes equivalent. The decrease was largely due to similar reasons as those for energy reduction, as well as sites switching to less carbon-intensive forms of energy.

Water use

Group water use was down by 5.9 per cent from 2009, at 4.15 cubic metres per million cigarettes equivalent produced, exceeding our 2012 target. This was largely due to an increased re-use of water, improved measurement due to the introduction of water meters and site rationalisation.

Landfill and recycling

Group waste to landfill decreased in 2010 by 5.3 per cent to 0.018 tonnes per million cigarettes equivalent produced, largely due to an increase in recycling and more detailed measurement allowing for efficiency improvements.

To find out more about our sustainability activities go to: **www.bat.com/sustainability**

Biodiversity Partnership

Since 2001, we have worked with three non-government organisations in the British American Tobacco Biodiversity Partnership: Fauna & Flora International, the Tropical Biology Association and Earthwatch Institute. Through the Partnership, we are involved in more than 30 biodiversity projects worldwide.

We donated £1 million per year to the Partnership in its first five years, and £1.5 million per year for the five years from 2006. In 2010, we agreed the scope of work for the next five years of the Partnership, with a commitment of £1.5 million per year. There will be fewer, but larger projects, focusing on biodiversity in agricultural landscapes and the ecosystems on which they depend.

Eliminating child labour

Child labour is a key human rights issue for any industry that has an agricultural supply chain and tobacco growing is no exception.

We tackle the problem through our Social Responsibility in Tobacco Production (SRTP) programme and through our continued active involvement in the Eliminating Child Labour in Tobacco Growing (ECLT) Foundation, which brings together representatives of all the major manufacturers and leaf suppliers, tobacco growers, trade unions and the International Labour Organisation (ILO).

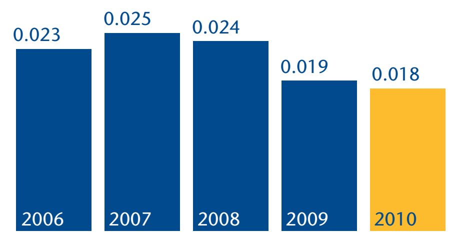
Corporate social investment

Our corporate social investment (CSI) activities include a range of community and charitable projects, centred on empowerment (giving people training, education and opportunities to help them develop), civic life (activities that aim to enrich public and community life) and sustainable agriculture and environment (contributions to local agriculture).

Our global CSI expenditure in 2010 was £15.4 million (2009: £14 million) as defined by the statutory reporting criteria for charitable donations.

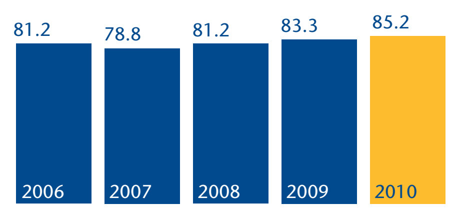
Waste to landfill

Tonnes per million cigarettes equivalent



Recycling

Percentage of waste recycled



Recognition of our work

In 2010, The Economics of Ecosystems and Biodiversity (TEEB) initiative, led by the United Nations Environment Programme, recognised our Biodiversity Partnership and Social Responsibility in Tobacco Production (SRTP) as an effective example of how businesses can address the issue of biodiversity.

Brand performance

We recognise that our business starts with our consumers and our brands, and our balanced portfolio is designed to deliver sustained growth.

Our brands

We have a strong portfolio of brands to cover consumers' specific preferences and pricing expectations.

Global Drive Brands +7% in 2010

KENT

LUCKY STRIKE

DUNHILL SINCE 1907

PALL MALL

Other international brands +2%

Our three largest international brands, excluding GDBs, are:

Vogue VICEROY KOOL

200+ brands in a balanced portfolio covering the Premium, Value-For-Money and Low-Price segments

Our leading brands

We have four leading Global Drive Brands (GDBs) that provide around 34 per cent of Group total revenue. These brands are Dunhill, Kent, Lucky Strike and Pall Mall.

Dunhill offers a range of premium and super-premium cigarettes and cigars at the top end of the market. Sold in more than 120 countries, key markets include South Korea, Malaysia, Brazil, Taiwan, Saudi Arabia, South Africa and Australia.

Kent is our largest premium brand, sold in more than 70 countries. Key markets include Russia, Japan, Kazakhstan and Romania. The brand was successfully launched in South Korea in 2010.

Lucky Strike was launched in 1871 and is now sold in more than 60 countries. Key markets include Germany, Spain, Japan, France, Italy, Argentina and Chile.

Pall Mall is our leading global value-for-money brand. Introduced in 1899, it now offers a range of cigarette and make-your-own products sold in more than 100 countries. Key markets include Germany, Russia, Uzbekistan, Mexico and Malaysia.

Other international brands

Other key brands in our portfolio include Vogue and Viceroy. Vogue is a premium brand selling in more than 55 countries. Key markets include Russia, South Korea, France, Italy and Canada. Viceroy is sold in more than 40 countries. Introduced in 1936, key markets today include Turkey, Poland, Russia, the Czech Republic and Argentina.

Other famous international brands, familiar to smokers around the world, include **Kool**, **Peter Stuyvesant**, **Rothmans**, **Benson & Hedges** and **State Express 555**.

The market in 2010

Continued economic uncertainty in 2010 has had an adverse effect on consumer confidence in some markets. This has presented us and our competitors in the legitimate tobacco industry with further challenges from illicit trade, and total global volumes declined slightly during the year, partly due to some consumers down-trading to cheaper illegal products.

High-performing brand portfolio

Despite this, our GDBs and other international brands continued to grow in 2010, adding to the value of our business across the Group. Our overall GDB volumes grew by 7 per cent, driven by offering value-adding innovation to consumers and successful brand migrations.

Since 2005, the GDB share of our global volumes has increased by 11 percentage points. In 2010, our international brands as a whole accounted for more than 50 per cent of total volumes for the first time.

Key local brands with high consumer loyalty such as Yava in Russia and Free in Brazil continue to play an important role in our brand strategy, as they help us maintain a broad portfolio that meets specific consumer needs.

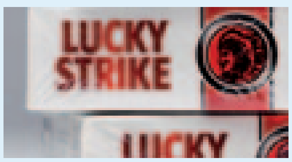
We are confident that our brand portfolio, balanced across markets, segments and price points, and supported by consumer-relevant innovation, remains well positioned to continue its success.

You can read more about our balanced brand portfolio at:
www.bat.com/brands

Percentage of our volume accounted for by our international brands as a whole

50+

Global Drive Brands in 2010



Lucky Strike

Cigarettes sold (billion)	26 (2009: 26)
Volume growth	+2% (2009: +4%)
Number of markets	60+ (2009: 60+)

Pall Mall

Cigarettes sold (billion)	73 (2009: 68)
Volume growth	+8% (2009: +10%)
Number of markets	100+ (2009: 80+)

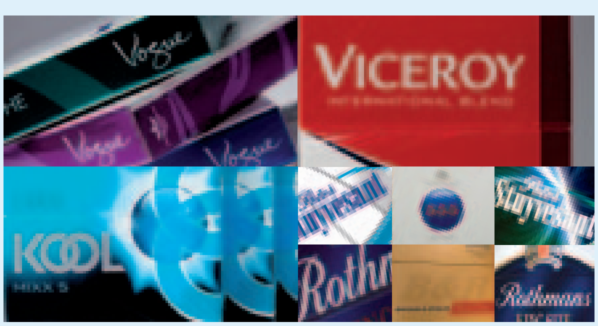
Kent

Cigarettes sold (billion)	61 (2009: 61)
Volume growth	-1% (2009: -4%)
Number of markets	70+ (2009: 70+)

Dunhill

Cigarettes sold (billion)	48 (2009: 41)
Volume growth	+18% (2009: +9%)
Number of markets	120+ (2009: 120+)

Other international brands



Our other international brands are sold in around 150 markets worldwide

Cigarettes sold (billion)	150 (2009: 147)
Volume growth	+2% (2009: +3%)

Global market overview

The tobacco industry remains relatively resilient to global economic pressures, but recession inevitably impacts consumer confidence and disposable incomes. While this has seen volumes decline, the overall value of the industry continues to grow.

The demand for our international brands is growing

Our international brand volumes and market shares are increasing in many markets. This trend, supported by consumer-relevant innovation, can increase our sales and profits, even where overall market volumes are declining.

Consumer focus

Understanding smokers' preferences and buying behaviour is the starting point with innovations. We aim to develop product and packaging developments that will be truly relevant to consumers' tastes, attitudes, disposable income and purchasing patterns.

The global tobacco market

Global marketplace

The global tobacco industry produces more than 5,400 billion cigarettes a year. The biggest single market is China, where the industry is state-owned, with some 350 million smokers who account for more than 40 per cent of the global total.

Four international tobacco companies – Philip Morris International, British American Tobacco, Japan Tobacco and Imperial Tobacco – account for some 45 per cent of the global market, or around three-quarters of the market outside China.

The illicit trade in tobacco products is a serious problem in many countries – meaning that up to 12 per cent of global volume is traded on the black market.

Economic outlook

The global economic environment remains tough and uncertain. While some emerging economies may grow fast in 2011, recovery in advanced economies is likely to be fragile for some time and high unemployment levels are a concern.

Value of the industry

All the 'big four' tobacco companies face an increasingly competitive marketplace but the overall value of the industry is still growing. There are big opportunities to improve the product and price mix, primarily in developing markets.

We believe consumers are increasingly looking for and expecting real value, so quality and innovation both play a key role in delivering market share.

Illicit trade in tobacco products

Cigarettes are among the most commonly traded products on the black market due to high profit margins, the relative ease of production and movement, and low detection rates and penalties.

The principal drivers of illicit trade are economic – cheaper cigarettes for consumers and profits for the smugglers and counterfeiters. Contributory factors include sudden increases in excise, weak border controls and ineffective sanctions.

Estimates suggest that up to 660 billion illegal cigarettes are smoked every year. This has a negative impact on consumers, retailers, governments and tobacco companies. For consumers, illegal cigarettes can mean fake products with no quality controls, no health warnings or, where genuine products are smuggled, health warnings that do not meet local government regulations.

It is estimated that governments worldwide are losing up to £24 billion a year in excise and other taxes, while the loss to legitimate tobacco companies could be as much as £6 billion a year in revenue.

We believe tackling this illegal trade effectively requires cooperation between the industry, regulators and enforcement authorities. We support governments' establishment of appropriate tax policies, strong regulation and effective enforcement. In 2010, we signed a cooperation agreement with the European Commission and the member states of the European Union to tackle the problem of illicit trade.

Industry outlook

World consumption
Trends indicate that individual smokers will consume fewer cigarettes each and smaller percentages of populations will smoke. However, with the world's population predicted to increase to seven billion by the end of 2012 and nine billion by the end of 2050, we believe that there will be a very sustainable and important tobacco industry for a long time to come.

Increasing regulation
Regulation is becoming increasingly stringent, supported by the World Health Organisation's Framework Convention on Tobacco Control.

Appropriate health warnings on packs and other primary packaging have been part of the industry for decades. However, a move towards plain packaging for tobacco products could make criminals' lives easier. Counterfeit products would become easier to produce and branded illicit products that do not comply with regulations could become more attractive to consumers.

Retail display bans could also lead to an increase in illicit trade by driving the sale of the legal product under the counter and could also distort competition among tobacco companies.

Excise
Many national governments use tobacco taxation as a key instrument to reduce rates of smoking, while also raising significant excise revenue. However, sudden increases in excise rates can destabilise markets and result in consumers switching to cheaper illicit products.

Gradual and predictable increases in excise can be more effective for governments, helping to maintain an orderly market that both enables tax revenues to be increased and supports public health policy.

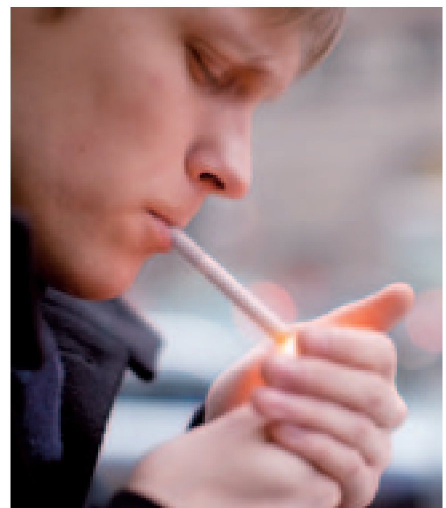
Focus on excise

36%

In January 2010, illicit cigarettes in Romania reached a peak market share of 36 per cent, over double their 2008 share of 16 per cent.

This was largely the result of a sharp rise in excise, which significantly increased the price of cigarettes. Rather than generate the expected revenue, this meant that the Romanian Government stood to lose €1 billion in unpaid taxes in 2010 if illicit trade remained at the same level.

For more information about tobacco taxes, see **www.bat.com/tax**



Ireland's illegal cigarette trade
It is estimated that one in four cigarettes consumed in Ireland have been smuggled into the country. This illegal trade accounts for around 1.5 billion cigarettes, costing the country €0.5 billion in lost tax revenue.

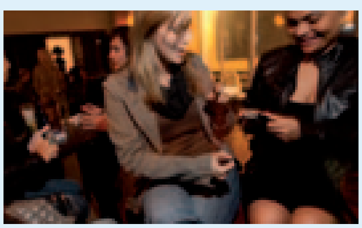
Ireland has the most expensive cigarettes in the EU due to high excise, with prices more than double the EU average. The Minister for Finance decided not to increase excise in 2010, acknowledging that the high prices were giving rise to massive cigarette smuggling.

Our business model for sustainable growth

Our business model is designed to deliver sustainable growth in earnings per share of 7-9 per cent on average. Through the consistent application of our Group strategy we can deliver the revenue growth that will enable us to achieve our ambition of leading our industry and, as a result, build shareholder value. We can only sustain this growth if it is funded by improved productivity across the business and delivered by a winning organisation that acts responsibly at all times.

Consumers

Our success depends on really understanding the different profiles and preferences of our consumers.

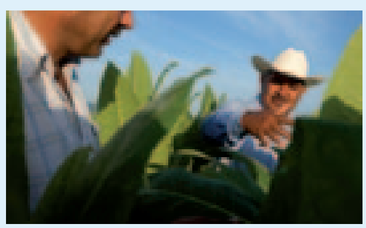


We recognise that our business starts with our consumers and our brands. We invest in gathering comprehensive insights into smokers' preferences and buying behaviour. This information helps us offer product innovations that are relevant to adult consumers' tastes, attitudes, pockets and purchasing patterns. Our aim is to create value for our business and our consumers by meeting their needs and offering appropriate quality. Our brand portfolio remains evenly balanced across all price points – Low-Price, Value-For-Money and Premium – to ensure we can continue to develop consumer loyalty.

To find out more about our consumers go to: **www.bat.com/consumers**

Sourcing

We work with tobacco farmers and other suppliers to promote high ethical, environmental and work place standards.

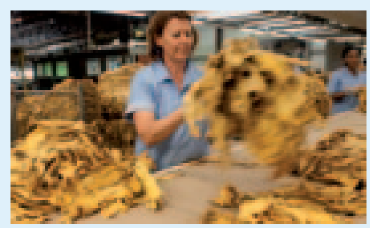


We are the only tobacco business with a significant interest in tobacco growing and we work directly with around 70 per cent of the farmers we purchase our leaf from. We also purchase significant quantities of other raw materials, such as packaging, cigarette paper, filter materials, glues and inks. We manage our supply chain responsibly and engage with our suppliers to help address their social, environmental and economic impacts. This engagement creates a shared understanding of our supply chain, enabling us and our suppliers to make better decisions, generate efficiencies and effectively manage risks.

To find out more about our sourcing go to: **www.bat.com/sourcing**

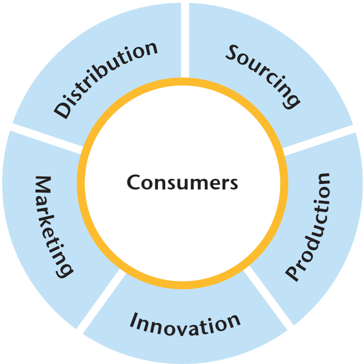
Production

Manufacturing tobacco products is a large-scale operation and we have factories all over the world.



We work to ensure that our costs are globally competitive and that we use our resources as effectively as possible. To improve productivity and to continue building a sustainable business, our companies have closed or downsized some factories and consolidated production elsewhere in recent years. We fully recognise the impacts of these actions and work hard to mitigate the outcomes for employees and the wider community. These changes also enable us to rationalise our machinery and technology to establish a more cost-effective operational base for the future.

To find out more about our production go to: **www.bat.com/production**



Innovation

We make significant investment into the development of our innovations and into research and development.

We invest in our brands and the development of product innovations to drive growth. These innovations vary across our brands, brand variants and markets and our approach enables our companies to adapt their offers flexibly to local preferences. Our guiding focus when designing innovations is on relevance to the consumer, speed to market and the ability to continuously improve our products. We also invest significantly in our efforts to develop potentially reduced-harm products that will be accepted by consumers and will be recognised by scientific and regulatory authorities.

To find out more about our innovation go to: www.bat.com/innovation

Marketing

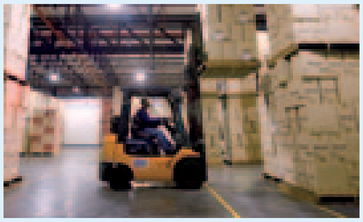
We have a successful marketing strategy based on innovation, responsibility and consumer choice.

Our balanced brand portfolio, including our four Global Drive Brands – Dunhill, Kent, Lucky Strike and Pall Mall – is designed to meet key consumer needs, especially in our strategic consumer segments – Premium, Adult Smokers Under 30 (ASU30) and Fresh Taste.
Our marketing is driven by an excellent understanding of the consumer and by sticking to the marketing fundamentals that are appropriate to our products.
We market in ways that allow us to satisfy consumer preferences, while responding to reasonable stakeholder expectations about how we should market tobacco products wherever we operate.

To find out more about our marketing go to: www.bat.com/marketing

Distribution

We work with our retail partners to ensure that they can profitably meet the expectations of adult smokers.



Our routes to market are a critical enabler of our growth strategy. They allow us to quickly roll-out innovations on a global scale and to fully meet consumer demand. We continuously review our routes to market to ensure we remain competitive and this includes our relationships with wholesalers, distributors and logistics providers. Our direct to store sales (DSS) are often the most effective way of serving retailers and building business partnerships.
DSS allows us to create shared value throughout the sales and distribution process and provides a direct commercial link to our most strategic retail accounts.

To find out more about our distribution go to: www.bat.com/distribution

Creating sustainable value

Underpinning our business model, sustainability for us is all about shared value – creating economic value in a way that also creates value for our stakeholders.

Shared value

Our balanced strategy adds value at every stage of our business operations, including working directly with tobacco farmers, manufacturing our own products and investing in research and development. We think this sets us apart from our competitors and ensures our long-term business sustainability, helping us to manage risks better and presenting us with efficiencies and growth opportunities.

However, sustainability for us is all about shared value – creating economic value in a way that also creates value for our stakeholders. This means seeking opportunities to increase our competitiveness through addressing our sustainability impacts and by better meeting society's needs and expectations. This can be through developing new reduced-harm products, by creating a great place to work or by minimising our environmental impacts.

Over the years we have built a strong reputation for sustainability and have been seen by some as leaders in our industry. From being the first tobacco company to be included in the Dow Jones Sustainability World Index, continuing our inclusion to date; to receiving a number of reporting awards; to achieving platinum status in the UK Business in the Community Corporate Responsibility Index.

Our sustainability agenda

However, we cannot overcome our sustainability challenges alone. We need to engage with our stakeholders to develop solutions together. We can use our insights from this dialogue to make the right decisions, not only for our business but also for our stakeholders, to create shared value.

We developed our sustainability agenda in 2007 and it focuses on our five goals – harm reduction, marketplace, environment, supply chain, and people and culture.

We are making good progress in many areas. Our successes include advances in the science of harm reduction, completing biodiversity risk and opportunity assessments in all our leaf-growing operations and developing a more integrated supply chain strategy.

We know we have more to do before sustainability becomes ingrained in every part of our organisation. We aim to ensure that our sustainability agenda supports the growth of the business by taking advantage of the opportunity it presents and by developing solutions to future challenges.

Value opportunities

For example, we are trying to develop reduced-harm products that will appeal to consumers and will hopefully create growth in our business when launched. We also provide broad-based agronomy advice to farmers, which includes support to grow other crops as well as tobacco. This comprehensive approach to sustainable agriculture helps farmers gain better yields and a higher income as well as securing our supply of high-quality leaf.

We also look to create value for consumers, governments and the industry in our approach to tackling the illicit trade in tobacco products. We believe governments and the tobacco industry need to work together to manage the market and remove some of the causes of illicit trade, while cooperating on prevention. This requires sensible excise programmes, robust customs enforcement, retailer and consumer education and sensible regulation.

Sustainability focus in 2010

Our focus in 2010 has been on embedding our approach to sustainability across the Group and implementing activities in each of the five areas of our sustainability agenda. A brief summary of our progress in 2010 is shown on the facing page.

Dow Jones Sustainability Indexes

In 2010, we were, for the ninth year running, included in the Dow Jones Sustainability World Index. This Index tracks the economic, environmental and social performance of leading companies based on how well they integrate sustainability into their businesses. In 2010, our overall score decreased from 81 per cent to 78 per cent. We are working to identify opportunities for improvement and hope to soon see our performance improve.

You can find out more about our strategy and our approach to sustainability elsewhere in this Annual Report.

For more details on our progress against our sustainability agenda, see our online Sustainability Report 2010, published at the same time as this report, at:
www.bat.com/sustainability

2010 progress in brief

Harm reduction

We will strive to bring commercially viable, consumer acceptable reduced-risk products to market.

We believe we are making a significant contribution to the science needed to assess potentially reduced-exposure products. The results of our first clinical studies have been analysed and we have made good progress in developing laboratory models of how diseases progress and reinvigorated our biotechnology programme. We continue to both publish and present our scientific results whenever we can and engage with regulators.

Marketplace

We will take a lead in upholding high standards of corporate conduct within our marketplace.

We have continued to coordinate a consistent approach to key regulatory issues by our companies. Our global approach to youth smoking prevention was rolled out across the Group. We are also piloting a system to strengthen supply chain security and have entered into a cooperation agreement with the European Commission to tackle illicit trade in tobacco.

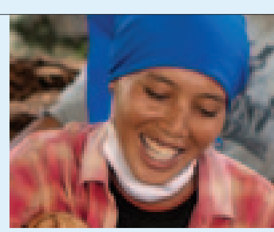
Environment

We will actively address the impacts of our business on the natural environment.

We made good progress in reducing our environmental impacts. We also held stakeholder dialogue, an independently facilitated session where we met with relevant stakeholders and our external assurance team, to develop our approach to water management. All our leaf-growing operations completed biodiversity risk and opportunity assessments and have corrective action plans in place where appropriate.

Supply chain

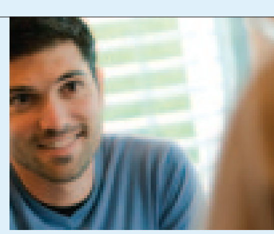
We will work for positive social, environmental and economic impacts in our supply chain.



We held a stakeholder dialogue session for suppliers and are developing an environmental scorecard together. Our Social Responsibility in Tobacco Production assessment now contains minimum thresholds. We are aiming for zero use of natural forest by our contracted farmers by 2015. We also developed a plan for reducing the use of natural resources at our factories and have piloted efficiency initiatives in our logistics network.

People and culture

We will work to ensure we have the right people and culture to meet our goals.



We held a stakeholder dialogue session to examine how the needs of business and the expectations of employees can be aligned to create a sustainable organisation. Ninety per cent of our employees responded to our biennial opinion survey. Our health and safety strategy was updated and we extended the human rights criteria we apply in our own operations to our business partners.

Business review
Corporate governance
Financial statements
Other information

Regional review

> "Revenue growth of 5 per cent, and organic revenue at constant rates up by 3 per cent, with Global Drive Brand volume up 7 per cent, is a very good performance."

John Daly
Chief Operating Officer

2010 highlights

- **Reported Group revenue up by 5 per cent to £14,883 million**
- **Group organic revenue growth of 3 per cent at constant rates**
- **Volumes 2 per cent lower at 708 billion. Group organic volumes down by 3 per cent**
- **Overall market share grew in the Top 40 Group markets**
- **Global Drive Brand volumes up 7 per cent**
- **Other international brands up 2 per cent**
- **Adjusted profit from operations at constant rates of exchange was up 6 per cent to £4,745 million**

Group revenue grew by 5 per cent in 2010. This was the result of favourable exchange rate movements, continued good pricing momentum and the acquisition of PT Bentoel Internasional Investama Tbk (Bentoel) in the middle of 2009. Organic Group revenue was up 3 per cent at constant rates of exchange.

The reported profit from operations was 5 per cent higher at £4,318 million, with a 12 per cent increase if adjusting items (as explained on page 36) are excluded. The major difference between the growth rates of adjusted profit from operations compared to the reported profit, is the goodwill and trademark impairment write-downs in respect of Turkey, as further described on page 36. All of the regions contributed to this good profit result, except for Eastern Europe where there were significantly lower industry volumes in Romania, driven by illicit trade, and an adverse exchange rate in Uzbekistan. Adjusted profit from operations was 6 per cent higher at constant rates of exchange, with all regions growing.

Group volumes from subsidiaries were 708 billion in 2010, down 2 per cent on last year despite the acquisition of Bentoel. This was a result of lower industry volumes in some markets – mainly Turkey, Pakistan, Romania and South Africa – and an increase in illicit trade.

Group market share in the Top 40 markets increased with a particularly strong performance in the second half of 2010.

The Global Drive Brands (GDBs) achieved good overall volume growth of 7 per cent following the launch of successful innovations, and this resulted in a continued improvement in market share. Excluding brand migrations, growth was 3 per cent.

Dunhill increased volumes by 18 per cent in 2010, mainly as a result of brand migrations in Brazil and South Africa and strong growth in the Gulf Cooperation Council (GCC), Russia, France, Nigeria and Indonesia. Kent was 1 per cent lower after industry volume declines in two of its main markets, Japan and Romania, despite growing market share in both. Volumes were up in Russia, Ukraine and Uzbekistan.

Lucky Strike volumes were 2 per cent higher with growth in many markets, including France, Chile and Argentina. However, this was partially offset by declines in its main markets of Germany, Spain and Japan. Pall Mall volumes increased by 8 per cent, with growth in Germany, Uzbekistan, Italy, Spain, Pakistan, Nigeria and Chile, partially offset by lower volumes in Russia, Romania, Hungary and Turkey.

Other international brands excluding GDBs grew by 2 per cent, with good performances by Vogue, Benson & Hedges, Craven 'A', John Player Gold Leaf and Rothmans.

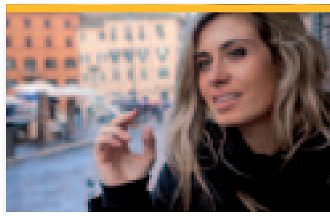
Regional financial highlights

	Volumes		Revenue		Adjusted profit*	
	2010 bn	2009 bn	2010 £m	2009 £m	2010 £m	2009 £m
Asia-Pacific	188	185	3,759	3,270	1,332	1,148
Americas	149	151	3,498	3,156	1,382	1,186
Western Europe	119	130	3,419	3,884	1,054	994
Eastern Europe	128	131	1,686	1,628	358	409
Africa and Middle East	124	127	2,521	2,270	858	724
Total	708	724	14,883	14,208	4,984	4,461
Revenue and adjusted profit from operations, restated at constant rates of exchange	–	–	14,263	14,208	4,745	4,461

* The profit discussed in the Regional review is based on adjusted profit from operations and therefore excludes the impact of restructuring and integration costs, amortisation and impairment of trademarks, goodwill impairment and gains on disposal of businesses and trademarks.

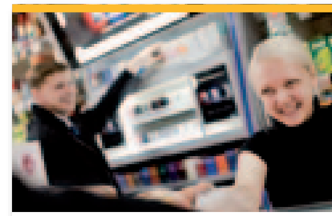
Americas

Volume (bn)	149
Revenue (£m)	3,498
Adjusted profit (£m)	1,382
Employees	16,423
Share of Group volume (%)	21



Western Europe

Volume (bn)	119
Revenue (£m)	3,419
Adjusted profit (£m)	1,054
Employees	14,476
Share of Group volume (%)	17



Eastern Europe

Volume (bn)	128
Revenue (£m)	1,686
Adjusted profit (£m)	358
Employees	6,828
Share of Group volume (%)	18

Africa and Middle East

Volume (bn)	124
Revenue (£m)	2,521
Adjusted profit (£m)	858
Employees	6,856
Share of Group volume (%)	17

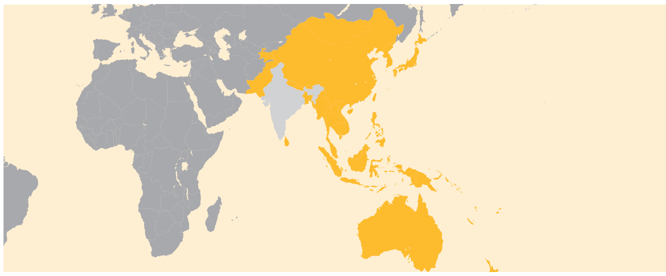
Asia-Pacific

Volume (bn)	188
Revenue (£m)	3,759
Adjusted profit (£m)	1,332
Employees	15,848
Share of Group volume (%)	27

2011 regional structure
The new regional structure is explained on page 33.

Regional review (continued)

Asia-Pacific



Where we are located

The region includes the following major markets:

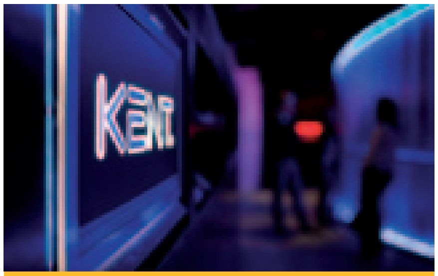
- Australia
- Bangladesh
- Indonesia
- Japan
- Malaysia
- New Zealand
- Pakistan
- South Korea
- Taiwan
- Vietnam

"We're having success with innovations on powerful brands, and it shows in our market share growth."

David Fell
Director Asia-Pacific

27%
Percentage of Group volume

£1,332m
27% of Group adjusted profit



Share growth in South Korea

In 2010 we launched Kent Convertibles in South Korea, to great success. The innovative menthol-flavoured capsule technology not only saw us grow market share, it also contributed to us finishing the year at an all-time high level of share in the country.

In **Asia-Pacific**, profit was up £184 million to £1,332 million as a result of strong performances in Japan, Australia, New Zealand and Bangladesh. Favourable exchange rates and the acquisition of Bentoel were also contributing factors. At constant rates of exchange, profit would have increased by £47 million, or 4 per cent. Volumes were 2 per cent higher at 188 billion, due to increases in Bangladesh and Vietnam and the additional volumes from Bentoel, although these were partially offset by lower volumes in Australia, Japan, Taiwan and Pakistan.

Australia achieved strong profit growth through higher pricing and continued cost saving initiatives. Good performances from both Pall Mall and Winfield led to an increase in market share, although an ad-hoc excise increase in May 2010 resulted in a drop in industry volumes.

In New Zealand, profit increased due to beneficial exchange rate movements and strong growth in share by Pall Mall. However, volumes were lower, impacted by an ad-hoc excise increase and a tax equalisation for roll-your-own products.

Market share in Malaysia was up, although the share gained by Peter Stuyvesant and the resilient performances by Kent and Dunhill were partially offset by the impact of down-trading. Volumes were slightly lower due to both legal industry volume decreases as a result of hefty excise rises, and increased illicit trade. Profit was up as a result of exchange rate movements and price increases, partially offset by lower volumes and higher marketing investment.

Profit grew strongly in Japan, benefiting from increased margins, exchange rate movements and lower overheads. Although industry volumes were down, following the excise rise on 1 October 2010, market share grew. Kent returned to share growth, driven by the successful launch of Nanotek, and Kool continued to grow share.

Vietnam had a solid performance with market share gains and good volume growth, mainly due to Craven 'A'.

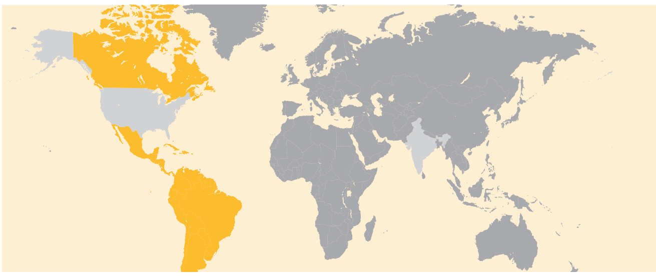
South Korea closed the year with market share at a record high, supported by the successful launch of Kent and the growth of Dunhill in the second half of the year. However, volumes were lower due to the contraction of the industry. Profit decreased as a result of lower volumes and investment into the launches of Kent and Dunhill innovations.

Excise and inflation-led price increases in Pakistan, combined with supply chain disruption caused by floods, led to lower volumes and accelerated down-trading to the Low-Price segment and the illicit sector. Profit was adversely affected by the mix deterioration, increased costs and lower volumes.

Bangladesh achieved significantly higher market share. Operating profit was higher, reflecting improved volumes and the impact of excise-led price increases, as well as a tight control on costs.

Volumes, market share and profit in Indonesia grew through the acquisition of Bentoel and the subsequent integration with the existing business. Profit grew strongly on a comparable basis as a result of higher volumes, price increases and synergy savings resulting from the integration.

Americas



Where we are located

The region includes the following major markets:

- Argentina
- Brazil
- Canada
- Chile
- Colombia
- Mexico
- Venezuela

"We had an excellent year in the Americas in 2010, driven by market share growth and Global Drive Brand performance."

Mark Cobben
Director Americas

21%
Percentage of Group volume

£1,382m
28% of Group adjusted profit

In **Americas**, profit rose by £196 million to £1,382 million. This was mainly due to strong performances from Canada, Brazil and Chile, an improved product mix and exchange rate benefits. At constant rates of exchange, profit would have risen by £62 million, or 5 per cent. Volumes were down 1 per cent at 149 billion, with the small decreases experienced in Brazil and Venezuela as a result of industry declines almost offset by higher volumes in Canada and Chile.

Profit growth in Brazil was driven by higher pricing, an improved product mix and a stronger local currency. Market share in the Premium segment grew due to solid performances from Lucky Strike as well as Dunhill after the migration from Carlton. Overall market share was higher, although price increases led to lower industry volumes.

Profit in Canada was higher, with the effect of reduced illicit trade, price increases and exchange rate benefits more than offsetting continued down-trading. Substantial progress was also made on the cost base. Volume grew following a significant reduction in illicit trade due to the enforcement activities of authorities. The Group gained leadership in all cigarette segments in Canada, which contributed to a significant market share improvement, driven by John Player Standard.

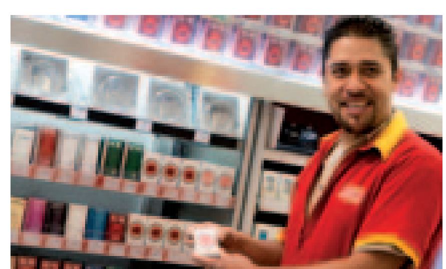
In Mexico, profit was higher as a result of an improved operating margin and volume stability after many years of market decline, driven by trade-stocking in December 2010 in anticipation of a price increase. Market share stabilised with good performances from Pall Mall and Montana and the launch of Dunhill in the third quarter.

In Argentina, Dunhill was launched in the last quarter of the year, and Lucky Strike showed strong volume and share growth as it capitalised on consumers' up-trading.

However, profit was impacted by lower volumes and higher marketing investment.

Volumes increased in Chile, driven mainly by strong performances from Lucky Strike and Pall Mall. Profit grew significantly as a result, enhanced by price rises ahead of an excise increase, an improved product mix and lower overheads.

Market share in Venezuela was up in a contracted market. However, price increases did not cover the impact of currency devaluation on costs, higher expenses and lower volumes, which resulted in a lower profit. Market share and volumes in Colombia were maintained, although profit was slightly down.

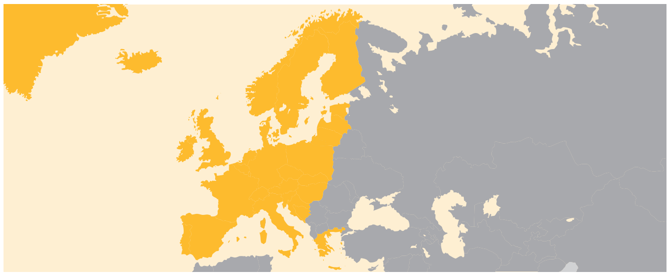


Innovation drives growth

The Americas region led the way in the roll-out of the new Lucky Strike Click & Roll menthol capsule innovation. Click & Roll was launched in five countries during the year. This led to significant growth across the region for the year.

Regional review (continued)

Western Europe



Where we are located

The region includes the following major markets:

- Belgium
- Denmark
- France
- Germany
- Greece
- Italy
- The Netherlands
- Poland
- Spain
- Sweden
- Switzerland
- United Kingdom

"We've made excellent progress on our operating margin and we achieved good market share performance in the second half of the year."

Jack Bowles
Director Western Europe

17%
Percentage of Group volume

£1,054m
21% of Group adjusted profit

Spain grows market share

Spain grew market share from 9 per cent to 13 per cent in 2010, driven by both Pall Mall and Lucky Strike. Pall Mall grew share through distribution expansion and the successful launch of Semi Slims, while Lucky Strike gained market share through the launch of Click & Roll.

Profit in **Western Europe** increased by £60 million to £1,054 million, mainly as a result of strong performances in Germany, Belgium, Spain, Poland, Sweden and the Netherlands, although this was partially offset by declines in Denmark, Italy and Greece. At constant rates of exchange, profit would have increased by £87 million, or 9 per cent. Regional volumes were 8 per cent lower at 119 billion as a result of declines in Poland, Germany, Switzerland and the Netherlands.

In Italy, an improved mix, coupled with a price increase and lower costs, offset some of the volume decline, although profit was depressed by an adverse exchange rate. Market share was slightly down on last year, despite share growth of Global Drive Brands and overall share increasing over the last quarter.

Profit in Germany increased as a result of higher margins from price increases in 2009 and lower costs, despite the termination of the Gauloises licence agreement at the end of March. Market share was the same as last year. On a like-for-like basis, volumes were slightly down in a contracting market, despite an excellent performance by Pall Mall.

Volumes in France were stable, which kept profit in line with last year. Improved pricing and lower product costs were offset by an unfavourable product mix and marketing investment.

Profit and market share were both up strongly in Spain, driven by a favourable pricing environment and good performances by Pall Mall and Lucky Strike. Volumes were slightly down in a declining total market.

Profit was maintained in Switzerland, benefiting from price increases and lower costs. Volumes were lower, impacted by industry contraction. Market share was down although Parisienne maintained its overall share at an historic high.

The restructuring of the commercial units of Belgium and the Netherlands into one organisation was completed on 1 June 2010. There was a good growth in profit as a result of higher pricing and lower costs.

Profit increased strongly in Poland as two price increases more than offset the impact of lower industry volumes. Market share decreased despite the strong growth of Viceroy.

In Greece, industry volume declined due to excise and VAT increases during the first half of the year and lower consumer disposable income. Although market share was up, volumes were slightly lower. Profit dropped significantly due to competitor pricing and as a result of lower volumes.

Volumes and profit in Denmark were lower due to the rationalisation of various tail brands and down-trading following two significant excise increases.

Market share grew and volume increased in the United Kingdom, mainly as a result of the good performance of Pall Mall, which resulted in a significant increase in profit.

Eastern Europe

Where we are located

The region includes the following major markets:

- Kazakhstan
- Romania
- Russia
- Ukraine
- Uzbekistan

"We have achieved good market share growth in both premium and local brands and there are very encouraging signs of economic recovery in the region."

Des Naughton
Director Eastern Europe

18%
Percentage of Group volume

£358m
7% of Group adjusted profit

Profit in the **Eastern Europe** region decreased by £51 million to £358 million. This was principally due to lower volumes and the adverse impact of exchange rates, mainly in Uzbekistan, although this was partly offset by price increases. At constant rates of exchange, profit would have increased by £19 million, or 5 per cent. Volumes at 128 billion were 2 per cent lower, mainly due to industry declines in Romania. Market share grew in the majority of markets and regional share was also higher.

Price increases and the improved product mix in Russia increased profit. Market share grew, despite volumes being in line with last year. The Group achieved leadership in the Premium segment and market share leadership in Moscow as a result of continued excellent performances by Kent and Dunhill.

Market share in Romania was up strongly, with an impressive performance by the market leader, Kent. Increased illicit trade due to numerous large excise-driven price increases meant industry volumes declined significantly. The volume decline was only partially offset by price increases, leading to a lower profit.

In Ukraine, market share increased strongly, and excellent profit growth was achieved as a result of an improved product mix, led by growth in Global Drive Brands and stronger pricing. Group volumes increased.

Results improved in Kazakhstan due to higher margins. Market share was up as a result of a strong performance by Kent and Pall Mall. The decrease of the Premium segment resulted in slightly lower volumes.

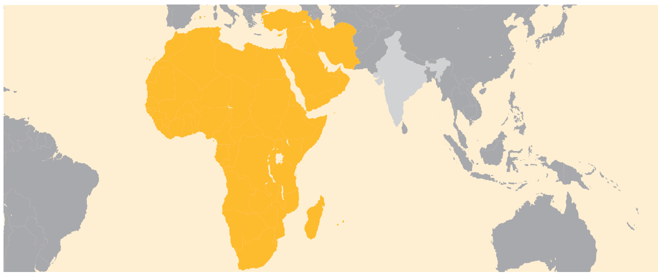
In Uzbekistan, market share grew strongly, driven by the growth of Kent and Pall Mall. However, industry volumes were lower as a result of an excise increase and profit was significantly impacted by adverse exchange rates.

GDBs perform well in Ukraine

Ukraine gained significant market share in 2010. This increase was largely a result of strong performances by Pall Mall as well as by Kent Convertibles, which has achieved over four times the market share of its nearest competitor.

Regional review (continued)

Africa and Middle East



Where we are located

The region includes the following major markets:

- Egypt
- The Gulf Cooperation Council (GCC)
- Nigeria
- South Africa
- Turkey

"We've had strong profit and market share growth in a number of key markets."

Andrew Gray
Director Africa and Middle East

17%
Percentage of Group volume

£858m
17% of Group adjusted profit

Profit from the **Africa and Middle East** region grew by £134 million to £858 million in 2010. At constant rates of exchange, profit would have improved by £69 million, or 10 per cent, mainly driven by Nigeria and the Gulf Cooperation Council (GCC). Volumes were 2 per cent lower at 124 billion, following declines in Turkey, Iran and South Africa. However, these were partially offset by increases in the GCC, Egypt and Nigeria.

In South Africa, market share grew following strong performances by Peter Stuyvesant and Kent, aided by the successful migration of Courtleigh to Dunhill. Volumes were down after an almost doubling of illicit trade. However, the profit impact of this was mitigated by increased pricing and cost reduction initiatives, helped by a stronger exchange rate.

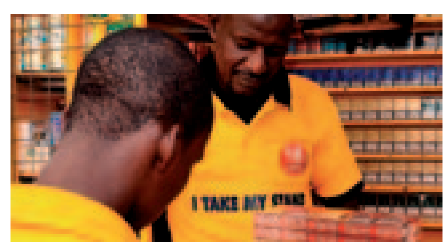
Nigeria achieved strong volume growth. Coupled with higher prices and cost reductions, this led to an impressive profit performance. A reduction in illicit trade, rural market expansion and effective distribution across all channels contributed to volume growth. Market share also grew strongly, with excellent performances from Dunhill and Pall Mall.

In the GCC markets, volume, market share and share in the Premium segment grew strongly, with Dunhill and John Player Gold Leaf the main contributors. Profit was significantly higher, benefiting from volume growth and stronger pricing.

In the rest of the Middle East volumes were lower, although this was partially offset by a strong performance in the Levant. Profit was lower as a result of a decline in volumes and higher brand investment in the Levant.

An aggressive excise-driven price increase in Turkey in January 2010 led to an almost doubling of illicit trade. Nevertheless, profit rose as price increases, favourable exchange movements and reduced production overheads offset the impact of lower volumes. The brand portfolio acquired in the Tekel transaction was particularly affected by the growth in illicit trade and competitor pricing.

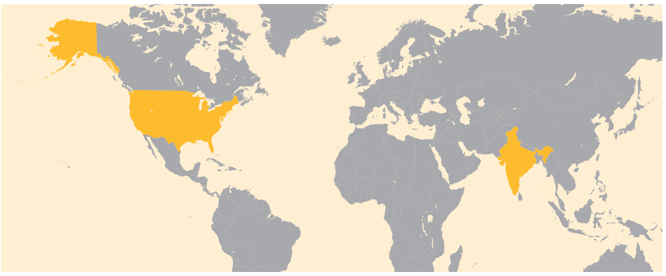
In Egypt, volumes and market share continued their impressive growth trend, despite the excise-led price increases in July. However, profit was adversely impacted as the excise increase was only partially recovered through higher prices. Rothmans had a good performance, expanding its leadership position among international brands.



Strong performance in Nigeria

British American Tobacco Nigeria had an outstanding year in 2010 and has positioned itself as undisputed leader in one of the world's most challenging markets. As well as delivering profit, market and volume growth in 2010, the country has also seen a reduction in illicit trade.

Associates



Where we are located
Our principal associates are located in India and the US.

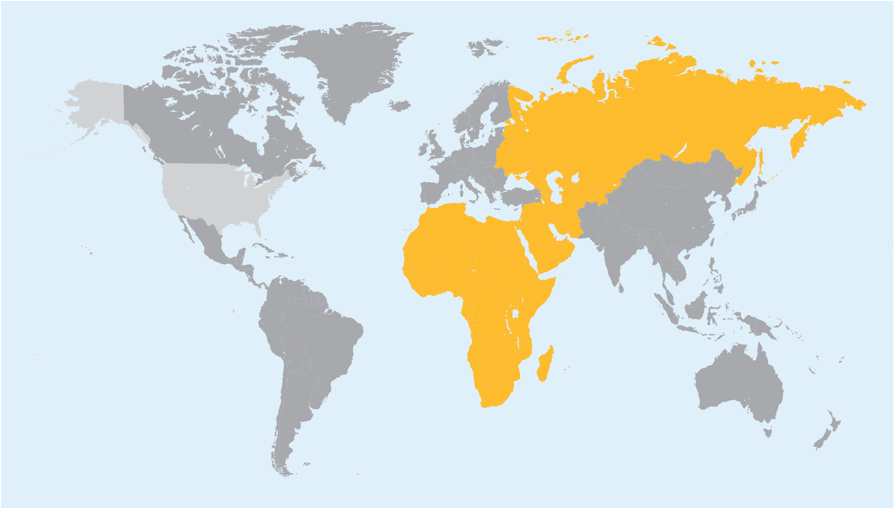
Associates principally comprise Reynolds American and ITC.

The Group's share of the post-tax results of associates, excluding the adjusting items explained on page 36, increased by 15 per cent to £622 million, with a rise of 11 per cent at constant rates of exchange.

The contribution from Reynolds American increased by 5 per cent to £346 million. Excluding the impairment and amortisation of trademarks and restructuring costs, as well as the past service credit for a health plan in 2009 and the Canadian settlement in 2010, the contribution was 5 per cent higher at £409 million. At constant rates of exchange the increase was 4 per cent.

The Group's associate in India, ITC, continued its strong profit growth, and its contribution to the Group rose by 35 per cent to £195 million. Excluding the impact of the dilution in the Group's shareholding, the contribution was 42 per cent higher at £204 million. At constant rates of exchange, the contribution would have been 33 per cent higher than last year.

2011 regional structure



Changes to our regional structure
As part of our plans to reduce complexity, drive efficiency in management structures and achieve a better balance in the scale of the regions, the number of regions is being reduced from five to four from 1 January 2011.

Markets which currently comprise the Eastern Europe region will be merged into the Africa and Middle East region and the Western Europe region. Russia, Ukraine, Moldova, Belarus, Caucasus and Central Asia will form part of the new Eastern Europe, Middle East and Africa region (EEMEA) while Romania, Bulgaria, Serbia, Montenegro, Albania and Kosovo will become part of the Western Europe region.

Financial review

"With good business momentum, sound financing and the announced share buy-back, shareholders can look forward to continued superior returns."

Ben Stevens
Finance Director and Chief Information Officer

2010 highlights

- **Revenue grew by 5 per cent**
- **Profit from operations up 5 per cent to £4,318 million**
- **Adjusted profit from operations increased by 12 per cent**
- **Adjusted diluted earnings per share increased by 15 per cent to 175.7 pence per share**
- **Dividends for 2010 up by 15 per cent to 114.2 pence per share**
- **Strong free cash flow of £3,240 million, up 23 per cent**
- **Free cash flow equal to 92 per cent of adjusted earnings**
- **Share buy-back of £750 million announced for 2011**

Profit from operations

The reported Group revenue grew by 5 per cent to £14,883 million. Profit from operations at £4,318 million was also 5 per cent higher.

The growth in Group revenue at constant rates of exchange was slightly up, to £14,263 million but organic revenue growth at constant rates of exchange was 3 per cent higher.

In order to better understand the underlying performance of the business, it is necessary to adjust for a number of items relating, for example, to restructuring costs and impairments. We call the underlying profit after adjusting for these items adjusted profit. These adjustments are described further below.

Adjusted profit from operations was £4,984 million, up 12 per cent from £4,461 million in 2009. Adjusted profit from operations translated at constant rates of exchange, was up 6 per cent to £4,745 million.

Organic growth

For 2010, revenue growth was enhanced by the full year benefit of the acquisition of PT Bentoel Internasional Investama Tbk in the middle of 2009. On the other hand, the Group revenue was affected by the termination of the Gauloises agreement in Germany at the end of the first quarter and the disposal of the Belgium distribution business, Lyfra NV, on 25 June 2010. During 2010, we made the decision to withdraw from distributing phone cards in Brazil. Adjusting for these transactions, revenue would have been up 3 per cent to £13,814 million at constant rates of exchange. On the same basis, adjusted profit from operations grew organically by 6 per cent to £4,722 million at constant rates of exchange.

Operating margin

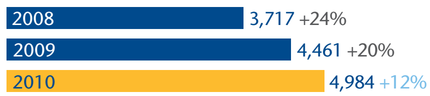
In 2008, following the success of the previous five year programme of cost savings which ended in 2007, the Group launched a new five year programme – targeting annual savings of £800 million by 2012. It includes areas such as supply chain efficiencies, back office integration and slimmer management structures. During the first three years of the programme the targeted savings of over £800 million were achieved, two years ahead of schedule. The Group will in future focus on an alternative measure, operating margin, with a target, as previously announced, of at least 35 per cent by 2012.

The cost reduction initiatives and the disposal of the Lyfra distribution business resulted in the adjusted profit from operations as a percentage of revenue improving to 33.5 per cent, compared to 31.4 per cent in 2009 and 30.7 per cent in 2008. More details of the Group's operating performance can be found in the Regional review.

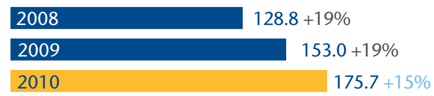
Percentage increases in revenue and in profit from operations

	Revenue growth	Profit growth
As reported	+5%	+5%
Adjusted	+5%	+12%
Adjusted at constant rates	0%	+6%
Adjusted organic at constant rates	+3%	+6%

Adjusted profit from operations
£ million



Adjusted diluted EPS
Pence



Analysis of revenue and profit from operations

Revenue

	2010					2009		
	Reported revenue £m	Impact of exchange £m	Revenue at CC[1] £m	Organic adjust-ments[3] £m	Organic revenue at CC[1] £m	Reported revenue £m	Organic adjust-ments[3] £m	Organic revenue £m
Asia-Pacific	**3,759**	**311**	**3,448**	**(112)**	**3,336**	3,270	–	3,270
Americas	**3,498**	**296**	**3,202**	**(117)**	**3,085**	3,156	(170)	2,986
Western Europe	**3,419**	**(67)**	**3,486**	**(220)**	**3,266**	3,884	(594)	3,290
Eastern Europe	**1,686**	**(40)**	**1,726**	**–**	**1,726**	1,628	–	1,628
AME	**2,521**	**120**	**2,401**	**–**	**2,401**	2,270	–	2,270
Total	**14,883**	**620**	**14,263**	**(449)**	**13,814**	14,208	(764)	13,444

Profit from operations

	2010							2009		
	Profit[2] £m	Adjusting items £m	Adjusted profit[2] £m	Impact of exchange £m	Adjusted profit[2] at CC[1] £m	Organic adjust-ments[3] £m	Organic adjusted profit[2] at CC[1] £m	Adjusted profit[2] £m	Organic adjust-ments[3] £m	Organic adjusted profit[2] £m
Asia-Pacific	**1,276**	**(56)**	**1,332**	**137**	**1,195**	**(19)**	**1,176**	1,148	–	1,148
Americas	**1,346**	**(36)**	**1,382**	**134**	**1,248**	**(3)**	**1,245**	1,186	(6)	1,180
Western Europe	**818**	**(236)**	**1,054**	**(27)**	**1,081**	**(1)**	**1,080**	994	(15)	979
Eastern Europe	**358**	**–**	**358**	**(70)**	**428**	**–**	**428**	409	–	409
AME	**520**	**(338)**	**858**	**65**	**793**	**–**	**793**	724	–	724
Total	**4,318**	**(666)**	**4,984**	**239**	**4,745**	**(23)**	**4,722**	4,461	(21)	4,440

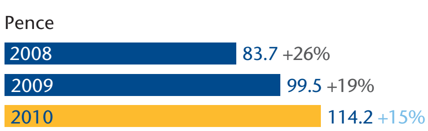
Notes
(1) CC: Constant currencies
(2) Profit: Profit from operations
(3) Organic adjustments: Merger and acquisition and discontinued activities – adjustments are made to the 2009 and 2010 numbers, based on the 2010 Group position

Financial review (continued)

Operating margin

Underlying tax rate

Dividend per share declared



Free cash flow per share as a ratio of adjusted diluted earnings per share

Adjusting items

The adjustments made to profit from operations are separately disclosed as memorandum information on the face of the income statement and in the segmental analysis.

During 2010, the Group continued to incur costs as a result of restructurings not related to the day-to-day operations of the business.

These initiatives include restructuring the Group's manufacturing operations, organisation structure and systems and software used. During 2010, we also impaired goodwill and trademarks relating to the acquisition of Tekel by £293 million. The total amount of these adjustments, together with the costs of integrating acquired businesses into existing operations and trademark amortisation, was £666 million for the year ended 31 December 2010, compared to £360 million for 2009.

Restructuring and integration costs in 2010 principally relate to the continuation of factory closure and downsizing activities in Denmark and Australia respectively; the closure of the Jawornik factory in Poland, the Tire factory in Turkey and the Lecce factory in Italy. They also included a voluntary separation scheme and the closure of the printing unit in Argentina and the continued integration of Bentoel into existing operations; as well as combining the Group's businesses in Belgium, Luxembourg and the Netherlands and some other activities to reduce the overheads of the Group.

Restructuring and integration costs in 2010 also include a payment of US$21 million to Reynolds American relating to the early termination of the Contract Manufacturing Agreement dated 30 July 2004.

Restructuring and integration costs in 2009 principally related to costs in respect of the planned closure of the Soeborg factory in Denmark; the planned downsizing of the manufacturing plant in Australia; and the continued integration of ST, Tekel and Bentoel with existing operations.

The acquisitions of the assets of Tekel and the ST businesses in mid-2008, as well as the Bentoel business in mid-2009, resulted in the capitalisation of trademarks which are amortised over their expected useful lives, which do not exceed 20 years. The 2010 amortisation charge in respect of trademarks amounted to £62 million, while it was £58 million in 2009.

Goodwill and trademarks recognised as a result of the Tekel acquisition in 2008 have been impaired by £249 million and £44 million respectively. Although cost saving initiatives in the acquisition plan have been delivered successfully, the impairment charge arises from intense pricing competition following significant excise increases during 2009 as well as further increases effective from January 2010, which resulted in growth in illicit trade and a loss of volumes and market share. Turkey remains an important market for the Group.

Net finance costs

Net finance costs at £480 million were £24 million lower than last year. The decrease principally reflects lower net debt and net interest gains on derivative contracts.

Associates

The Group's share of the post-tax results of associates, included at the pre-tax profit level under IFRS, increased by £67 million to £550 million, after net adjusting charges of £72 million (2009: £58 million). Excluding the adjusting items in 2009 and 2010, the Group's share of the post-tax results of associates increased by 15 per cent to £622 million, or 11 per cent at constant rates of exchange. The Group's share of the net adjusting items from Reynolds American amounted to an expense of £63 million (2009: £58 million) and included trademark amortisation and impairment charges, a Canadian settlement and restructuring charges, and in 2009, a health plan credit. Associates' income in 2010 also included a £9 million charge from accounting for the dilution in the Group's interest in ITC as a result of shares issued by the company in respect of its employee stock option scheme.

Profit before tax

Profit before tax was up £308 million at £4,388 million, reflecting the higher profit from operations, lower interest costs, the increased contribution from associates and favourable exchange rates.

Effective tax rate

The tax rates in the Income statement of 28.4 per cent in 2010 and 27.5 per cent in 2009 are affected by the inclusion of the share of associates' post-tax profit in the Group's pre-tax results and by the adjusting items.

The underlying tax rate for subsidiaries, reflected in the adjusted earnings per share below, was 30.2 per cent in 2010 and 30.3 per cent in 2009.

Earnings per share

Basic earnings per share for 2010 were 145.2p, up 6 per cent (2009: 137.0p). With the distortions that adjusting items can cause in profit, as well as the potentially dilutive effect of employee share schemes, earnings per share are best viewed on the basis of adjusted diluted earnings per share. The calculation of this measure is explained in note 7 of the financial statements.

On this basis, the adjusted diluted earnings per share was 175.7p, a 15 per cent increase over 2009, mainly as a result of the strong operating performance, lower net finance costs, an increased contribution from associates and benefits from foreign exchange movements.

Dividends

The Group's guidance is to pay dividends of 65 per cent of long-term sustainable earnings, calculated with reference to the adjusted diluted earnings per share. Interim dividends are calculated as one-third of the total dividends declared for the previous year.

Dividends declared

	2010		2009	
	Pence per share	£m	Pence per share	£m
Ordinary shares				
Interim	33.2	662	27.9	557
Final	81.0	1,607	71.6	1,431
	114.2	2,269	99.5	1,988

Dividends are declared and payable in sterling except for those shareholders on the branch register in South Africa, whose dividends are payable in rand. A rate of exchange of £:R = 11.54580 as at 22 February 2011, the closing rate for that day as quoted by Bloomberg, results in an equivalent final dividend of 935.20980 SA cents per ordinary share.

With the recommended final dividend of 81.0p, the total dividends per share for 2010 are 114.2p, up 15 per cent on the prior year. Under IFRS, the recommended final dividend in respect of a year is only provided in the accounts of the following year. Therefore, the 2010 accounts reflect the 2009 final dividend and the 2010 interim dividend amounting to 104.8p (£2,093 million) in total (2009: 89.5p – £1,798 million). The table above shows the dividends declared in respect of 2010 and 2009.

Treasury operations

Treasury is responsible for raising finance for the Group, managing the Group's cash resources and managing the financial risks arising from underlying operations. All these activities are carried out under defined policies, procedures and limits.

The Board reviews and agrees the overall treasury policies and procedures, delegating appropriate authority to the Finance Director, the Treasury function and the boards of the central finance companies. The policies include a set of financing principles and key performance indicators.

Clear parameters have been established, including levels of authority, on the type and use of financial instruments to manage the financial risks facing the Group. Such instruments are only used if they relate to an underlying exposure; speculative transactions are expressly forbidden under the Group's treasury policy. The Group's treasury position is monitored by the Corporate Finance Committee, which meets regularly throughout the year and is chaired by the Finance Director. Regular reports are provided to senior management and treasury operations are subject to periodic independent reviews and audits, both internal and external.

It is the policy of the Group to maximise financial flexibility and minimise refinancing risk by issuing debt with a range of maturities, generally matching the projected cash flows of the Group and obtaining this financing from a wide range of providers. The Group targets an average centrally managed debt maturity of at least five years with no more than 20 per cent of centrally managed debt maturing in a single rolling 12 months. As at 31 December 2010, the average centrally managed debt maturity was 7.4 years (2009: 6.6 years) and the highest proportion of centrally managed debt maturing in a single rolling 12 month period was 12.5 per cent (2009: 18.4 per cent).

Financial review (continued)

The Group continues to maintain investment-grade credit ratings; as at 31 December 2010 the ratings from Moody's and S&P were Baa1/BBB+ with a stable outlook (end 2009: Baa1/BBB+). The strength of the ratings has underpinned the debt issuance during 2009 and 2010 and the Group is confident of its ability to successfully access the debt capital markets.

Subsidiary companies are funded by share capital and retained earnings, loans from the central finance companies on commercial terms, or through local borrowings by the subsidiaries in appropriate currencies. All contractual borrowing covenants have been met and none are expected to inhibit the Group's operations or funding plans.

Liquidity

It is Group policy that short-term sources of funds (including drawings under the £1 billion euro commercial paper (ECP) programme) are backed by undrawn committed lines of credit and cash.

In the year ended 31 December 2010, the Group continued with transactions in the capital markets. In May 2010, the Group repaid a maturing €525 million bond. The repayment was financed from debt issued in November 2009. On 25 June 2010, the terms of €470 million of the €1 billion bond maturing in 2011 were modified by extending the maturity to 2020; at the same time, the Group issued an additional €130 million bond with a maturity of 2020. In addition, €413 million of the Group's €750 million bond maturing in 2012 was purchased and cancelled. At the same time, the Group issued a new £275 million bond with a maturity of 2040.

In December 2010, the Group negotiated a new central banking facility of £2 billion with a final maturity date of December 2015. This facility is provided by 22 banks. The existing central banking facility of £1.75 billion, with a final maturity date of March 2012 was cancelled at the same time. The facilities were undrawn as at the end of both years.

In mid-2009, the Group re-established its ECP programme of £1 billion, which was undrawn at 31 December 2010. At 31 December 2009, £187 million of ECP was outstanding.

There were a number of other transactions in the capital markets in 2009 to finance the repayment of bonds, to extend the maturity of other bonds and to finance the repayment of credit facilities used to finance the acquisition of Tekel in 2008. Details of these transactions are provided in notes 24 and 25 on the accounts.

Capital structure

The Group defines capital as net debt and equity. The only externally imposed capital requirement for the Group is interest cover. The Group targets interest cover, as calculated under its key central banking facilities, of greater than five. For 2010 it is 11.2 times (2009: 9.9 times). The only externally imposed capital requirement the Group has is in respect of its centrally managed banking facilities, which require a gross interest cover of 4.5. The Group assesses its financial capacity by reference to cash flow, net debt and interest cover. Group policies include a set of financing principles and key performance indicators including the monitoring of credit ratings, interest cover and liquidity. These provide a framework within which the Group's capital base is managed and, in particular, the policies on dividends (as a percentage of long-term sustainable earnings) and share buy-back are decided. The key objective of the financing principles is to appropriately balance the interests of equity and debt holders in driving an efficient financing mix for the Group.

The Group manages its financial risks in line with the classification of its financial assets and liabilities in the Group's balance sheet and related notes.

Cash flow

The IFRS cash flow statement on page 112 includes all transactions affecting cash and cash equivalents, including financing. The alternative cash flow statement is presented to illustrate the cash flows before transactions relating to borrowings.

Operating cash flow increased by £584 million or 14 per cent to £4,901 million, reflecting growth in underlying operating performance. Taking into account outflows relating to taxation, which were £83 million higher than last year due to higher taxable profits, an increase in restructuring costs due to the timing of payments and an increase in restructuring activities, as well as an increase in inflows relating to dividends received from associates, the Group's free cash flow was £610 million, or 23 per cent higher at £3,240 million.

The ratio of free cash flow per share to adjusted diluted earnings per share was 92 per cent (2009: 86 per cent), with free cash flow per share increasing by 23 per cent (2009: increasing by 2 per cent).

Below free cash flow, the principal cash outflows for 2010 comprise the payment of the prior year final dividend and the 2010 interim dividend. Proceeds on disposal of subsidiaries of £12 million which arose from the sale of the Group's Belgian distribution business, Lyfra NV, have been offset by a cash outflow of £12 million arising from the acquisition of non-controlling interests in subsidiaries.

The year ended 31 December 2009 included a net outflow of £382 million in respect of the purchase of Bentoel and Tekel, the proceeds from the ST trademark disposals and £2 million refunded from the original purchase consideration paid in 2008.

The other net flows principally relate to the impact of the level of shares purchased by the employee share ownership trusts and outflows in respect of certain derivative financial instruments.

The above flows resulted in net cash inflows of £1,070 million (2009: £433 million inflow). After taking account of exchange rate movements, net debt disposed and the change in accrued interest and other, total net debt was £7,841 million at 31 December 2010, down £1,001 million from £8,842 million on 31 December 2009.

Retirement benefit schemes

The Group's subsidiaries operate around 180 retirement benefit arrangements worldwide. The majority of the scheme members belong to defined benefit schemes, most of which are funded externally and many of which are closed to new entrants. The Group also operates a number of defined contribution schemes.

The present total value of funded scheme liabilities was £5,365 million (2009: £5,250 million), while unfunded scheme liabilities amounted to £337 million (2009: £282 million). The scheme assets increased from £4,634 million in 2009 to £5,134 million in 2010.

After accounting for minimum funding obligations of £29 million (2009: £75 million), excluding unrecognised funded scheme surpluses of £51 million (2009: £52 million) and £1 million for unrecognised past service costs in 2009, the overall net liability for all pension and health care schemes in Group subsidiaries amounted to £648 million at the end of 2010, down from £1,024 million at the end of 2009.

Contributions to the defined benefit schemes are determined after consultation with the respective trustees and actuaries of the individual externally funded schemes, taking into account the regulatory requirements.

Cash flow and net debt movements

	2010 £m	2009 £m
Adjusted profit from operations	**4,984**	4,461
Depreciation, amortisation and impairment	**442**	446
Other non-cash items in operating profit	**59**	25
Profit from operations before depreciation and impairment	**5,485**	4,932
Increase in working capital	**(61)**	(100)
Net capital expenditure	**(523)**	(515)
Gross capital expenditure	**(584)**	(554)
Sale of fixed assets	**61**	39
Operating cash flow	**4,901**	4,317
Net interest paid	**(491)**	(499)
Tax paid	**(1,178)**	(1,095)
Dividends paid to non-controlling interests	**(234)**	(234)
Restructuring costs	**(219)**	(187)
Dividends from associates	**461**	328
Free cash flow	**3,240**	2,630
Dividends paid to shareholders	**(2,093)**	(1,798)
Net investment activities	**–**	(196)
Purchases of subsidiaries and non-controlling interests	**(12)**	(383)
Disposal of subsidiaries and trademarks	**12**	187
Net flow from share schemes and other	**(77)**	(203)
Net cash flow	**1,070**	433
External movements on net debt		
Exchange rate effects*	**(41)**	672
Net debt disposed/(acquired)	**11**	(84)
Change in accrued interest and other	**(39)**	28
Change in net debt	**1,001**	1,049
Opening net debt	**(8,842)**	(9,891)
Closing net debt	**(7,841)**	(8,842)

*Including movements in respect of debt related derivatives

Financial review (continued)

Changes in the Group

In April 2010, the Group announced that it had agreed to sell its Belgium distribution business, Lyfra NV. The transaction was completed on 25 June 2010 for a consideration of €16 million. The disposal will have negligible impact on Group profit, but the company contributed over £400 million to revenue.

In 2009, after the acquisition of Bentoel, BAT Indonesia was merged with the company and from 1 January 2010, is trading under the Bentoel name.

Share buy-back programme

In 2009, the Board decided to suspend the on-market share buy-back programme that the Group initiated in 2003, in order to preserve the Group's financial flexibility during the period of economic uncertainty. No shares were bought-back during 2009 and 2010. The Board has approved the resumption of the on-market share buy-back programme in 2011 with a value of up to £750 million.

Regional structure from 2011

As part of our plans to reduce complexity in our management structure and to achieve a better balance in the scale of our regions, the number of regions will reduce from five to four with effect from 1 January 2011. As a result, the Eastern Europe region will be merged into the Africa and Middle East region and the Western Europe region. The Russia, Ukraine, Moldova, Belarus, Caucasus and Central Asia markets will form part of the new Eastern Europe, Middle East & Africa (EEMEA) region. The Western Europe region will now include the South Eastern Europe (SEE) Area, consisting of Romania, Bulgaria, Serbia, Montenegro, Albania and Kosovo. The Group's Asia-Pacific and Americas regions will remain unchanged.

The 2010 segmental information has been re-allocated on the basis of the new regional structure and is presented as part of note 2 to the financial statements.

Net debt/financing

The Group defines net debt as borrowings, including related derivatives, less cash and cash equivalents and current available-for-sale investments. The maturity profile of net debt is as follows:

	2010 £m	2009 £m
Net debt due within one year		
Borrowings	**(1,334)**	(1,370)
Related derivatives	**(29)**	33
Cash and cash equivalents	**2,329**	2,161
Current available-for-sale investments	**58**	57
	1,024	881
Net debt due beyond one year		
Borrowings	**(8,916)**	(9,712)
Related derivatives	**51**	(11)
	(8,865)	(9,723)
Total net debt	**(7,841)**	(8,842)

Non-GAAP measures

In the reporting of financial information, the Group uses certain measures that are not required under International Financial Reporting Standards (IFRS), the generally accepted accounting principles (GAAP) under which the Group reports. The Group believes that these additional measures, which are used internally, are useful to users of the financial information in helping them to understand the underlying business performance.

The principal non-GAAP measures which the Group uses are adjusted profit from operations and adjusted diluted earnings per share, which is reconciled to diluted earnings per share. These measures remove the impact of adjusting items from earnings.

Management reviews current and prior year segmental adjusted profit from operations of subsidiaries and adjusted post-tax results of associates and joint ventures at constant rates of exchange. This allows comparison of the Group's results had they been translated at last year's average rate of exchange. Other than in exceptional circumstances, this does not adjust for the normal transactional gains and losses in operations which are generated by exchange movements.

In the presentation of financial information, the Group also uses another measure, organic growth, to analyse the underlying business performance. Organic growth is the growth after adjusting for merger and acquisition and discontinued activities. Adjustments are made to current and prior year numbers, based on the 2010 Group position.

The Group also prepares an alternative cash flow, which includes a measure of 'free cash flow', to illustrate the cash flow before transactions relating to borrowings. The Group also provides gross turnover as an additional disclosure to indicate the impact of duty, excise and other taxes.

In accordance with the secondary listing of the ordinary shares of British American Tobacco p.l.c. on the main board of the JSE Limited ('JSE') in South Africa, the Group is required to also present headline earnings per share.

Accounting developments

The Group has prepared its annual consolidated financial statements in accordance with IFRS, as adopted by the EU. During 2010, a number of amended IFRSs and IFRIC interpretations have been adopted by the Group, which had no material effect on reported profit of the Group. IFRS 3 Revised and IAS 27 Revised changed the accounting for business combinations and transactions with non-controlling interests. IAS 27 Revised was applied to the acquisition of certain non-controlling interests in the year with the difference between the fair value of the consideration paid and the carrying value of the non-controlling interest, recognised directly in equity. Annual Improvements to IFRS introduced a number of minor changes, including revised disclosures under IFRS 8 on Operating Segments. As a result of this amendment, the Group no longer presents a measure of total assets for each reportable segment.

The next few years are likely to see more changes in the financial statements given the aims of standard setters and regulators.

Foreign currencies

The results of overseas subsidiaries and associates have been translated to sterling at the following exchange rates in respect of principal currencies:

	Average		Closing	
	2010	2009	**2010**	2009
US dollar	**1.546**	1.566	**1.566**	1.615
Canadian dollar	**1.592**	1.779	**1.556**	1.693
Euro	**1.166**	1.123	**1.167**	1.126
South African rand	**11.300**	13.091	**10.358**	11.891
Brazilian real	**2.719**	3.108	**2.599**	2.815
Australian dollar	**1.682**	1.990	**1.527**	1.796
Russian rouble	**46.945**	49.535	**47.795**	48.952

Going concern

Given the Group's history of growth in profit from operations, the high cash conversion rate from profit into cash, the access to the £2 billion revolving credit facility which is used only as a back stop and the spread of banks providing the facilities, the Group remains confident in its ability to access the debt capital markets.

This, together with the maturity profile of debt, spread over a long period with only limited redemptions scheduled for 2011, provides confidence that the Group has sufficient working capital for the foreseeable future.

After reviewing the Group's budget, plans and refinancing arrangements, the Directors consider that the Group has adequate resources to continue operating for the foreseeable future. The financial statements have therefore been prepared on a going concern basis. See the Corporate governance statement for full details.

Key Group risk factors

This section identifies the main risk factors that may affect the British American Tobacco Group's finances and operations.

These tables provide a brief description of the key risks to which the Group's operations are exposed and identifies, in each case, their potential impact on the Group and the principal activities in place to manage the risk. Each risk is considered in the context of the Group strategy by identifying the principal strategic element to which it relates, although other elements may also be relevant. The Group strategy is discussed in detail in the preceding pages of this Business review.

It is not the intention to provide an extensive analysis of all risks affecting the Group. Not all of the factors listed are within the control of the Group and other factors besides those listed may affect the performance of its businesses. Some risks may be unknown at present and other risks, currently regarded as immaterial, could turn out to be material in the future.

The risk factors listed in this section and the specific activities in place to manage them should be considered in the context of the Group's internal control framework, which is addressed in detail in the statement on internal control in the Corporate governance statement. This section should also be read in the context of the cautionary statement regarding forward-looking statements at the end of this section.

Risk registers are used at Group, regional, area and individual market levels. They are based on a standardised methodology, which was updated during 2010 to include information on prevailing trends in relation to each risk and to simplify and standardise the analysis of their impact and likelihood, which are now assessed at three levels (high/medium/low), instead of four previously. The Group risk register provides the basis for the assessment of the key Group risk factors identified below. It is reviewed by the Audit Committee twice yearly and one or more key risks are considered in detail at each Audit Committee meeting. The Board reviews the Group risk register annually.

The number of risks identified in this section has been reduced in comparison with previous years. This reflects both the updated risk management methodology and the Board's continuing reappraisal of Group risks. It also ensures that the list identifies only those risks and uncertainties that the Directors believe to be the principal ones facing the business, consistent with the guidance issued recently by the Financial Reporting Review Panel.

Illicit trade

Competition from illicit trade

Illicit trade in the form of counterfeit products, smuggled genuine products and locally manufactured products on which applicable taxes are evaded, represents a significant and growing threat to the legitimate tobacco industry. Increasing excise rates can encourage more consumers to switch to illegal cheaper tobacco products and provide greater rewards for smugglers. The risk is exacerbated where current economic conditions have resulted in high unemployment and/or reduced disposable incomes.

Principal relevance to Group strategy:
Potential impact on **Growth** (organic revenue growth)

Principal potential causes
- Sudden and disproportionate excise increases and widening excise differentials between markets.
- Ineffective regulatory environment.
- Economic downturn.
- Lack of law enforcement and weak border controls.

Potential impact on Group
- Erosion of brand equity.
- Reduced ability to take price increases.
- Investment in trade marketing and distribution is undermined.
- Product is commoditised.
- Lower volumes and reduced profits.

Principal activities in place to address risk
- Dedicated Anti-Illicit Trade (AIT) teams operating at global, regional, area and key market levels.
- Active engagement with key stakeholders.
- Global AIT strategy development supported by a research programme to further the understanding of the size and scope of the problem.
- AIT Intelligence Unit (including a dedicated analytical laboratory) cooperates with law enforcement agencies in pursuit of priority targets and capacity building.
- Strong internal business conduct and customer approval policies.

Other Group risks

As a result of the Group's updated risk management methodology and in consequence of the Board's continuing reappraisal of Group risks, a number of risks previously considered as key Group risks are no longer assessed as such in terms of their impact and likelihood, and so are not addressed in the following tables. Nevertheless, they remain on the Group risk register and continue to be reviewed in accordance with the Group's risk management procedures.

They include:

- Liquidity risk, including capital structure and leverage;
- Transactional foreign exchange exposures;
- Financial counterparty risks;
- Wrongly valued acquisition opportunities;
- Retirement benefits;
- Economic crisis impact on secondary supply chain;
- Trading performance in key markets;
- Loss of a smoking and health-related court case; and
- Disruption to the Group's information technology systems.

Excise and tax

Excise shocks from tax rate increases or structure changes

Tobacco products are subject to substantial excise and sales taxes in most countries in which the Group operates. In many of these countries taxes are generally increasing, but the rate of increase varies between countries and between different types of tobacco products.

Principal relevance to Group strategy:
Potential impact on **Growth** (organic revenue growth)

Principal potential causes

- Government initiatives to raise revenues.
- Increases advocated within context of national health policies.
- Insufficient capacity to engage with stakeholders in meaningful dialogue.

Potential impact on Group

- Consumers reject the Group's legitimate tax-paid products for products from illicit sources.
- Reduced sales volume or alteration of sales mix.

Principal activities in place to address risk

- Requirement for Group companies to have in place formal pricing and excise strategies including contingency plans.
- Pricing and excise committees at regional, area and individual market levels.
- Engagement with local tax and customs authorities where appropriate.
- Annual management review of brand portfolio, brand health and equity.

Onerous disputed taxes, interest and penalties

Principal relevance to Group strategy:
Potential impact on **Productivity** (capital effectiveness)

Principal potential causes

- Non-filing or late filing of tax returns or incorrect filings.
- Non-payment or late payments of taxes.
- Unfavourable ruling by tax authorities in disputed areas and aggressive auditing and/or pursuit of tax claims.

Potential impact on Group

- Significant fines and penalties.
- Disruption and loss of focus on the business due to diversion of management time.
- Impact on profit and dividend.

Principal activities in place to address risk

- Tax committees.
- Specialist resources available internally to provide advice and guidance and external advice sought where appropriate.

Key Group risk factors (continued)

Financial

The Group's underlying operations give rise to certain financial risks. The principal risks in this regard, and the controls in place to address them, are identified below and further details of the Group's financial management and treasury operations can be found within the Financial review.

Management of cost base

The Group continues to implement measures to reduce its overall cost base. There is a risk that targeted reductions will not be achieved and/or that productivity programmes do not achieve their objectives.

Principal relevance to Group strategy:
Potential impact on **Productivity** (cost management)

Principal potential causes	Potential impact on Group	Principal activities in place to address risk
• Insufficient resources devoted to productivity programmes due to other priorities. • Low prioritisation or resistance to change to overhead focus and targets.	• Inability to manage cost savings leads to lower profits and reduced funds for investment in long-term growth. • Reduced shareholder confidence.	• Programme in place to achieve cost savings of £800 million by 2012. • Development of a formal structure to integrate, drive and orchestrate the delivery of productivity programmes by providing visibility, establishing targets and enabling benefits tracking. • Regular tracking of actual productivity savings and forecast improvements in operating margin and supply chain, overheads and indirect projects.

Translational foreign exchange rate exposures

The Group faces translational foreign exchange (FX) rate exposures for earnings/cash flows from its global business.

Principal relevance to Group strategy:
Potential impact on **Productivity** (capital effectiveness)

Principal potential causes	Potential impact on Group	Principal activities in place to address risk
• FX rate exposures arise from exchange rate movements against sterling, the Group's reporting currency.	• Fluctuations in translational FX rates of key currencies against sterling introduce volatility in reported results.	• While translational FX exposure is not hedged, its impact is identified in results presentations and financial disclosures, and earnings are restated at constant rates for comparability. • Debt and interest are matched to assets and cash flows to mitigate volatility where possible.

Marketplace

The Group has substantial operations in over 180 countries. Its results are influenced by the economic, regulatory and political situations in the countries and regions in which it has operations, as well as by the actions of competitors.

Inability to obtain required price increases

To the extent that price increases are required to cover cost rises and deliver profit growth, there is a risk that the Group will be unable to achieve these.

Principal relevance to Group strategy:
Potential impact on **Growth** (organic revenue growth)

Principal potential causes
- Changes in the global economy reduce consumers' disposable income.
- Consumer down-trading.
- Competitors seek volume growth by price discounts or by not taking full price increases.

Potential impact on Group
- Reduction in volumes.
- Profit growth in the short term falls below shareholders' expectations.
- Reduction in funds for investment in long-term growth.

Principal activities in place to address risk
- Regular regional and management reviews of budgeted pricing scenarios.
- Pricing and excise committees at regional, area and individual market levels.
- Routine brand price trade-off exercises conducted in key markets.
- Competitor analysis and price war simulations.

Geopolitical tensions

Geopolitical tensions, including terrorism, have the potential to disrupt the Group's business operations.

Principal relevance to Group strategy:
Potential impact on **Growth** (organic revenue growth)

Principal potential causes
- Regional and/or global conflicts.
- Terrorism and political violence.
- Violent organised crime.
- The implementation of trade sanctions.
- Economic policy changes, including nationalisation of assets and withdrawal from international and bilateral trade agreements.

Potential impact on Group
- Potential loss of life, loss of assets and disruption to normal business processes.
- Increased costs due to more complex supply chain arrangements and/or the cost of building new facilities or maintaining inefficient facilities.
- Reduced volumes and impact on profits.
- Reputational impact of inability to protect staff and assets from serious harm.

Principal activities in place to address risk
- Globally integrated sourcing strategy and contingency sourcing arrangements.
- Security risk modelling, including external risk assessments and the monitoring of geopolitical and economic policy developments worldwide.
- Insurance cover and business continuity planning, including scenario planning and testing and risk awareness training.
- Security controls for field force, direct store sales, supply chain, with an emphasis on the protection of Group employees.

Key Group risk factors (continued)

Marketplace (continued)

Major impact of climate change

Climatic instability and degradation may lead to loss of traditional growing areas, relocation of office/factory sites, and supply chain disruption.

Principal relevance to Group strategy:
Potential impact on **Growth** (organic revenue growth)

Principal potential causes
- Increased production of CO_2 and other greenhouse gases as a result of human activity.
- Alteration of the Earth's global energy.
- Changes in ocean circulation or atmospheric composition.
- Natural disasters.

Potential impact on Group
- Loss of major leaf-growing area, market and/or major transportation facilities, including ports.
- Inability to obtain adequate supply of leaf and other production materials.
- Scarcity of skilled staff due to population migration.
- Potential loss of market share to competitors with changes in the geographical footprint.

Principal activities in place to address risk
- Group-wide sales and operational planning, including a globally integrated sourcing strategy and contingency sourcing arrangements.
- Group-wide environmental risk modelling and supporting insurance to cover financial exposure.
- Biodiversity risk and opportunity assessments specific to leaf-growing areas.
- Sustainability implementation plan covering the management and reduction of the Group's impact on natural resources and CO_2 generation.
- Research and development, including on drought-resistant tobacco types.

Legal and compliance

Breach of legal and contractual obligations

Non-compliance with any of the laws applicable to Group companies that could expose the Group to liabilities and reputational risks.

Principal relevance to Group strategy:
Potential impact on **Productivity** (capital effectiveness)

Principal potential causes
- Lack of understanding of applicable national and international laws and legal principles.
- Lack of understanding of contractual obligations or inconsistent contractual risks and assumptions.
- Dependency on third parties.

Potential impact on Group
- Unfavourable outcome or settlement of pending or future litigation.
- Material impact on consolidated results of operations, cash flows and financial position in a particular fiscal quarter or fiscal year.

Principal activities in place to address risk
- Comprehensive policies and procedures to promote legal compliance.
- Development of template contracts and standard provisions.
- Specialist resources available internally to provide advice and guidance and external advice sought where appropriate.

Regulation

The Group's businesses operate under increasingly stringent regulatory regimes around the world. Further regulation is expected, particularly as a result of the World Health Organisation's Framework Convention on Tobacco Control (FCTC) and, increasingly, active tobacco control activities outside the FCTC.

Regulation risks covering: packaging and labelling; advertising and promotion; design, contents and emissions of products; testing and measuring; and public place smoking

Strict and restrictive regulation in these areas may impair the Group's ability to communicate with adult smokers and/or to meet consumer expectations and may also impact on its ability to communicate with its corporate stakeholders. In addition, increased regulation may lead to increased operating costs and reduced sales.

Principal relevance to Group strategy:

Potential impact on **Growth** (organic revenue growth)

Principal potential causes

- Strict adoption of FCTC guidelines.
- Adoption of more stringent national regulations, such as point of sale display bans and plain packaging.
- Adoption of differing regulatory regimes in different countries/groups of countries and/or lack of consensus on interpretation/application.

Potential impact on Group

- Cost complexity of meeting regulations.
- Generic or plain packaging leads to loss of brand equity.
- Reduced ability to communicate brand portfolio and innovations, contributing to an increase in illicit trade.
- Contribution to the denormalisation of smoking.
- Reduced consumer acceptability of new product specifications, leading to loss of volume.
- Loss of reputation, penalties and closure of production as a result of non-compliance.

Principal activities in place to address risk

- Group companies have regulatory strategies in place in order to identify issues material to their operating environment and develop plans to address them in a manner consistent with local law and Group policy.
- Engagement is sought with scientific and regulatory communities and stakeholder engagement takes place at global, regional and individual market levels.
- Global monitoring of regulatory trends and developments and analysis of regulatory proposals to determine impacts, if any, on business.
- Development of dedicated technical and advocacy capabilities, corporate positions and best practice examples, supported by training, for markets to address regulation.
- Development of strategies and capabilities to develop and launch competitive, consumer-acceptable, fit-for-purpose products and new product initiatives within the changing regulatory environment.

Key Group risk factors (continued)

Regulation (continued)

Regulations are passed without the voice of the industry being taken into account

There is a risk that industry participation in the regulation discussion is reduced due to an inability to engage with authorities and put its points across effectively.

Principal relevance to Group strategy:
Potential impact on **Responsibility** (balanced regulation)

Principal potential causes
- Stringent adoption of FCTC guidelines on industry participation.
- National governments fail to take into account the views of the tobacco industry.
- The Group's advocacy of balanced regulation is not considered when regulation is formulated.

Potential impact on Group
- Exclusion of industry from participating in engagement with regulators and policy makers.
- Increased cost of business for legitimate industry, lower turnover and reduced profits.
- Diminished shareholder confidence leading to a reduced share price.

Principal activities in place to address risk
- Continued social dialogue.
- Regulatory and stakeholder engagement at global, regional and individual market levels, including the promotion of best practice in the formulation of regulation.

Data risks

Loss of confidential information or malicious manipulation of data

The loss or misuse of sensitive information, or its disclosure to outsiders, including competitors and trading partners, could potentially have a significant adverse impact on the Group's business operations and/or give rise to legal liability.

Principal relevance to Group strategy:
Potential impact on **Productivity** (cost management)

Principal potential causes
- Inadequate controls regarding the creation, storage and sharing of confidential information.
- Inadequate access controls to key systems and data.

Potential impact on Group
- Loss of revenue and/or profit due to use of inaccurate data, loss of trade secrets and/or competitors gaining advantage.
- Increased costs in restoring lost data and/or reversing inaccurate transactions.
- Regulatory action, civil action and/or criminal prosecution for breach of legal obligations.
- Damage to corporate reputation and loss of shareholder confidence.
- Negative impact on share price.

Principal activities in place to address risk
- Information technology controls.
- Established information security and information technology policies and procedures.
- Promotion of awareness and understanding of information security issues.

Cautionary statement

The Business review and certain other sections of this document contain forward-looking statements which are subject to risk factors associated with, among other things, the economic and business circumstances occurring from time to time in the countries and markets in which the Group operates. It is believed that the expectations reflected in these statements are reasonable but they may be affected by a wide range of variables which could cause actual results to differ materially from those currently anticipated.

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You can read more about our governance at:
www.bat.com/governance

Board of Directors

Board Committees

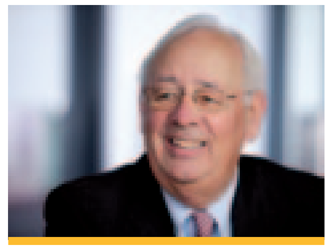
Committee membership is indicated by the following symbols:

■ Nominations Committee
▲ Audit Committee
● Remuneration Committee
◆ Corporate Social Responsibility Committee

Richard Burrows (65) ■
Position Chairman
Nationality Irish

He has been a Director since September 2009 and Chairman since November 2009 and serves as Chairman of the Nominations Committee. Richard's executive career has been with Irish Distillers, where he was Chief Executive from 1978-2000 and at Pernod Ricard, where he was Co-Chief Executive from 2000-2005, based in Paris. His current non-executive roles include Rentokil Initial and Carlsberg. He was Governor of the Bank of Ireland from 2005 until 2009.

Richard is a member of the Trilateral Commission which fosters closer co-operation among democratic industrialised nations and has also served as President of the Irish Business and Employers Confederation, Chairman of the National Development Corporation and Chairman of the Scotch Whisky Association.



Sir Nicholas Scheele (67) ■▲●
Position Senior Independent Non-Executive Director
Nationality British/US

Nick was appointed a Director in 2005 and Senior Independent Director in 2008. He also serves as a member of the Audit, Nominations and Remuneration Committees. Nick was President and Chief Operating Officer of Ford Motor Company until his retirement in 2005. He was Chancellor of Warwick University from 2002 until 2008.

Nick is Chairman of The Cambridge-MIT Institute, Key Safety Systems, Inc. (USA) and Global Metalsa SA de CV (Mexico) and a Director of Grupo Proeza (Mexico). He was knighted in 2001 for services to British exports.

Paul Adams (57)
Position Chief Executive
Nationality British

He was appointed a Director in March 2001 and Chief Executive in January 2004. Paul joined British American Tobacco in July 1991 and held senior appointments as Regional Director, Asia-Pacific and Regional Director, Europe prior to becoming Deputy Managing Director in June 2001 and Managing Director in January 2002.

Paul will retire as an Executive Director and Chief Executive on 28 February 2011.

Nicandro Durante (54)
Position Chief Executive Designate
Nationality Brazilian/Italian

He will become Chief Executive on 1 March 2011 having been Chief Executive Designate since 1 September 2010. Nicandro was appointed an Executive Director and Chief Operating Officer in 2008 having previously been Regional Director for Africa and Middle East and a member of the Management Board since 2006. He has also held senior general management roles in Brazil (including President of Souza Cruz) and in the UK and Hong Kong.

Nicandro holds degrees in finance, economics and business administration and, having joined British American Tobacco in 1981, has wide experience in senior international finance and management roles within the Group.

Ben Stevens (51)
Position Finance Director and Chief Information Officer
Nationality British

He has been Finance Director since 2008 and took on the additional role of Chief Information Officer in September 2010. Ben was appointed to the Management Board in 2001 as Development Director and as Director, Europe in 2004.

Ben is a graduate of Manchester University and the Manchester Business School in the UK and, since joining British American Tobacco in 1990, has held a number of senior finance and general management roles around the world including Head of Merger Integration following the merger with Rothmans and Chairman and Managing Director of the Pakistan Tobacco Company and Managing Director of British American Tobacco Russia.

John Daly (54)
Position Chief Operating Officer
Nationality Irish

He was appointed as an Executive Director and Chief Operating Officer in September 2010, having originally been appointed to the Management Board as Regional Director for Asia-Pacific in October 2004. Following the departure of the Group Human Resources Director, John will assume temporary responsibility for that function from 1 March 2011.

He was appointed a Director of the Group's associate company, Reynolds American Inc., in December 2010.

John joined the Group in 1994 and has held a number of senior management roles in Europe and the Far East including Area Director for the Middle East and North Africa in 2001.

Karen de Segundo (64) ■◆●
Position Non-Executive Director
Nationality Dutch

Karen was appointed a Director in 2007 and serves as Chair of the Corporate Social Responsibility Committee and as a member of the Nominations and Remuneration Committees. She joined Shell in 1971 and gained valuable experience in senior executive roles in several countries before retiring as CEO of Shell International Renewables and President of Shell Hydrogen in 2005.

Karen is currently a Non-Executive Director of Lonmin plc, Ensus Holdings Limited, E.ON AG, Pöyry Oyj and Royal Ahold NV. She is a Council Member of the Anglo Netherlands Society.

Robert Lerwill (59) ■▲●
Position Non-Executive Director
Nationality British

Robert was appointed a Director in 2005 and serves as Chairman of the Audit Committee and as a member of the Nominations and Remuneration Committees. He is currently Chairman of Synergy Health plc and a Non-Executive Director of Transcom Worldwide S.A.

Robert is a chartered accountant. He was formerly a Director of Cable & Wireless plc and WPP Group PLC where he was instrumental in developing and managing major international businesses for both companies. Robert also served as Chief Executive of Aegis Group plc until 2008.

Dr Ana Maria Llopis (60) ◆■●
Position Non-Executive Director
Nationality Spanish

Ana Maria was appointed a Director in 2003 and serves as a member of the Corporate Social Responsibility, Nominations and Remuneration Committees. She is Founder and Executive Chairman of Global ideas4all, Executive Deputy Chairman of the J F Llopis Foundation and a Director of Service Point Solutions, S.A. (Spain). Ana Maria was a member of the Good Governance Working Group for Spanish listed companies and has served as CEO of OpenBank (part of Banco Santander) and as a Non-Executive Director of ABN AMRO Bank from 2007 until March 2010.

Ana Maria will retire as a Non-Executive Director at the conclusion of the AGM on 28 April 2011.

Christine Morin-Postel (64) ■▲●
Position Non-Executive Director
Nationality French

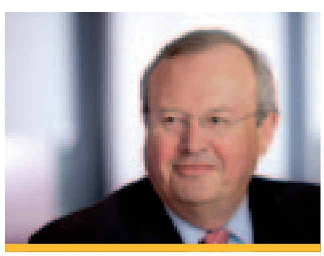
Christine was appointed a Director in 2007 and serves as a member of the Audit, Nominations and Remuneration Committees. She previously held a number of executive positions including Chief Executive of Société Générale de Belgique, Executive Vice-President and member of the Executive Committee of Suez and Chairman and CEO of Crédisuez S.A. before her retirement in 2003.

Christine is currently a Non-Executive Director of Royal Dutch Shell PLC, EXOR S.p.A. (Italy) and 3i Group plc.

Dr Gerry Murphy (55) ■◆●
Position Non-Executive Director
Nationality Irish

Gerry was appointed a Director in 2009 and serves as a member of the Corporate Social Responsibility, Nominations and Remuneration Committees. He is a Senior Managing Director at The Blackstone Group having previously been Chief Executive Officer of Kingfisher plc, Carlton Communications plc, Exel plc (formerly NFC plc) and Greencore Group plc. His earlier career included various management roles at Grand Metropolitan plc (now Diageo plc) in Ireland, the UK and the US.

Gerry's previous non-executive appointments have included Reckitt Benckiser plc, Abbey National plc, Novar plc and PJ Carroll Holdings plc, an Irish subsidiary of British American Tobacco.



Kieran Poynter (60) ■◆
Position Non-Executive Director
Nationality British

Kieran was appointed a Director on 1 July 2010 and serves as a member of the Corporate Social Responsibility and Nominations Committees. He is a Non-Executive Director of International Consolidated Airlines Group S.A., Nomura International PLC, F&C Asset Management PLC and The Royal Automobile Club Limited and has served on the President's Committee of the Confederation of British Industry.

Kieran, a chartered accountant, retired as Chairman and Senior Partner of PricewaterhouseCoopers in 2008 after 37 years with the firm during which time he lead the successful integration of Price Waterhouse and Coopers & Lybrand following their merger in 1998.

Anthony Ruys (63) ■▲●
Position Non-Executive Director
Nationality Dutch

Anthony was appointed a Director in 2006 and serves as Chairman of the Remuneration Committee and as a member of the Audit and Nominations Committees. He is a member of the Supervisory Boards of the Rijksmuseum and JANIVO Holdings BV (NL) and is a Director of Lottomatica S.p.A. (Italy). Anthony worked at Unilever for nearly 20 years before joining Heineken in 1993 as a member of its Executive Board, becoming Vice Chairman in 1996 and Chairman in 2002, before retiring in 2005.

In 2009 he was appointed a Non-Executive Director of the Group's Indian associate, ITC Limited, and, also in 2009, he became Chairman of the Supervisory Board of NV Luchthaven Schiphol (NL).

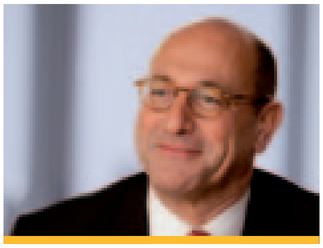
Management Board

The role of the Management Board

The Management Board, chaired by the Chief Executive, comprises the Executive Directors of British American Tobacco p.l.c. together with the executives shown on these pages. The Management Board has delegated responsibility for overseeing the implementation by the Group's operating subsidiaries of the policies and strategy set by the Board of Directors and for creating the conditions for their successful day-to-day operation.

Jack Bowles (47)
Position Director, Western Europe
Nationality French

Jack joined the Management Board as Director, Western Europe in October 2009. He joined the Group in 2004 and became President of British American Tobacco France in 2005. Jack became Managing Director of the Company's publicly listed subsidiary, British American Tobacco Malaysia, in 2007.



Mark Cobben (54)
Position Director, Americas
Nationality Dutch

Mark was appointed Director, Americas in January 2009, having joined the Management Board as Regional Director for Latin America and the Caribbean in October 2007. After a career at Unilever and Colgate he came to the Group in 1993 and has held a number of senior management positions including General Manager in Switzerland, Argentina, Russia and Germany.

David Fell (50)
Position Director, Asia-Pacific
Nationality British

David became Director, Asia-Pacific in September 2010, moving from the same role in Eastern Europe he had held since April 2008. He joined British American Tobacco in 1989 and has held a variety of marketing positions in Europe and South East Asia. He was then appointed President of British American Tobacco Japan in 2000 before being made Area Director, British American Tobacco Australasia and Managing Director, British American Tobacco Australia in October 2004.

Andrew Gray (46)
Position Director, Eastern Europe, Middle East and Africa
Nationality Brazilian/British

Andrew was appointed Director, Eastern Europe, Middle East and Africa on 1 January 2011 having joined the Management Board as Director, Africa and Middle East in January 2008. He joined British American Tobacco 24 years ago and has held a variety of senior marketing and general management roles in South America (including President of Souza Cruz) and also in Central America, the Caribbean and Malaysia.

You can read more about our governance at:
www.bat.com/governance

Rudi Kindts (53)
Position Group Human Resources Director
Nationality Belgian

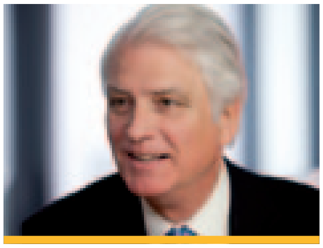
Rudi joined British American Tobacco in 1988. He has held a number of senior human resources roles across the Group (including Europe, Africa, the Middle East and Central and South Asia). He has been Group Human Resources Director since July 2004. Rudi will be leaving the Group on 28 February 2011.

Jean-Marc Lévy (48)
Position Group Marketing Director
Nationality Swiss

Jean-Marc was appointed Group Marketing Director in January 2010 after joining the Management Board as Director, Western Europe in April 2008. Jean-Marc began his career with the Kraft-Jacobs-Suchard Group and joined British American Tobacco in 1994 as Marketing Director in Switzerland. He went on to hold a variety of marketing and general management roles in Europe and South East Asia.

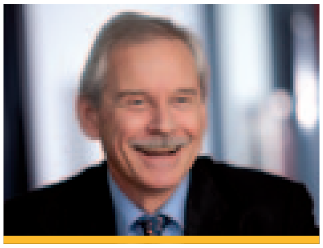
Des Naughton (44)
Position Group Operations Director Designate
Nationality British

Des was appointed Group Operations Director Designate on 1 January 2011 having joined the Management Board as Director, Eastern Europe in September 2010. He was previously Regional Head of Marketing, Africa and Middle East. Since joining the Group in 1995, he has held a number of general management and marketing roles across the world including Global Brand Director for Dunhill and General Manager, South Korea.



Michael Prideaux (60)
Position Group Corporate and Regulatory Affairs Director
Nationality British

Michael was appointed Group Corporate and Regulatory Affairs Director in 1998 following the demerger of B.A.T Industries. He had previously joined B.A.T Industries in 1989 from Charles Barker, a leading financial and corporate public relations, advertising and design agency, where he was Chief Executive.



Peter Taylor (58)
Position Group Operations Director
Nationality British

Peter joined British American Tobacco in 1980 and worked in a variety of operational and general management roles across the Group. He was appointed Group Operations Director in 2003. Peter will retire from British American Tobacco at the end of May 2011.

Neil Withington (54)
Position Group Legal and Security Director and General Counsel
Nationality British

Neil was appointed Group Legal and Security Director and General Counsel of British American Tobacco in 2000, having previously been the Group's Deputy General Counsel. He joined the Group in 1993 after a career at the Bar and in the chemical and pharmaceutical industries with ICI. He has been a Director of Reynolds American Inc. since 2004.

Corporate governance statement

"I embrace the new Code – it is directionally right and in many ways reflects what we already do. I am pleased to say that we are able to report against it a year early."

Richard Burrows
Chairman

Chairman's introduction

At British American Tobacco, we are committed to sustained high performance, supported by good governance. We want to run our business in a manner which is responsible and consistent with our belief in honesty, transparency and accountability. For us, good governance means managing our business well and engaging effectively with our stakeholders. It is never simply an exercise in compliance, but a key element underpinning the long-term growth of our business. As such, it is of key importance in these challenging times, as much as it is in the good times.

As a UK-listed company our principal reporting obligation arises under the Combined Code, now updated by the Financial Reporting Council and renamed the UK Corporate Governance Code. I embrace the new Code – it is directionally right and in many ways reflects what we already do. It applies to accounting periods beginning on or after 29 June 2010. Strictly speaking, we need not follow it until 2011, reporting in 2012, but I was keen that we report against it a year early. This Corporate governance statement, therefore, is intended both to meet our formal obligations under the Combined Code and to demonstrate our alignment with the new Corporate Governance Code.

The new Code emphasises the Board's responsibility for providing the leadership necessary to promote the long-term success of the Company within the context of an effective framework of controls which encourage talent, innovation and best practice, while managing and mitigating risk. As Chairman, I am conscious that it is my responsibility to provide leadership to the Board in order to ensure its effectiveness and to oversee the delivery of the Group's strategy. I am mindful in this regard of the importance of encouraging the productive engagement of all Board members so as to enable all Directors to work in unison within a culture of openness and debate. In this Statement, we identify how we apply the Code's principles relating to the role and effectiveness of the Board.

I am aware too of the need to have the keenest eye on risk management at the highest level, and the very real need for the Board to play a leadership role in ensuring the effectiveness of controls and the evaluation of risk. The renewed emphasis in the Code on risk management is consistent with our approach over the past two years, both in satisfying ourselves that our risk management processes are effective, and in extending our disclosure to assist investors and other stakeholders in understanding our principal risks and how we look to manage them. In addition, in the last year the Board has reviewed its overall approach to risk and agreed that it will continue to assess risks on a case-by-case basis.

The new Code has prompted some changes to our procedures. For example, our Board evaluation in 2010 benefited from an external facilitator, which provided a fresh perspective and produced some highly valuable learnings, as I hope this Statement will show. Similarly, I have felt it important this year to focus on ensuring that our Board members continue to update and refresh their skills and knowledge and so, in addition to scheduling additional briefing sessions, for example on the new Code, I met with each of of the Directors individually to discuss and agree their training and development needs in 2011. In another change to our previous practice, we will be submitting all of the eligible Directors for re-election at this year's Annual General Meeting.

I continue to follow with interest developments in the field of corporate governance, for example the government's recent consultation paper on the future of narrative reporting and its wider review of corporate governance, focusing on key issues such as the problems of short-termism, investor engagement and directors' remuneration. I was also present at the launch of the government's initiative, spearheaded by Lord Davies of Abersoch, aimed at increasing the presence of women on the boards of UK-listed companies. It is an initiative that I support and, while we have a better balance than many at Board level, we cannot be complacent and I am conscious that we need to continue to strive towards a better balance at the senior management level.

I am confident that British American Tobacco will continue to demonstrate resilience in these challenging times through its effective mix of good governance, a clear and consistent corporate strategy and excellent management. Our aim as a Board is simply to ensure that this effective combination continues to return enhanced value to our shareholders.

Richard Burrows
Chairman

You can read more about our governance at: www.bat.com/governance

Compliance statement

The principal governance rules applying to UK companies listed on the London Stock Exchange are contained in the Combined Code on Corporate Governance adopted in June 2008 (the 2008 Code). A new UK Corporate Governance Code was adopted in 2010 (the 2010 Code) and will apply in place of the 2008 Code to accounting periods beginning on or after 29 June 2010. Both Codes are published by the Financial Reporting Council and are available from its website (www.frc.org.uk).

Our formal obligation for 2010 is to report how the Company has applied the Main Principles of the 2008 Code and whether it has complied with the Provisions of that Code. Nevertheless, in keeping with our commitment to high standards of corporate governance, we have taken the opportunity during 2010 to meet the requirements of the 2010 Code. Accordingly, this Statement is intended to meet our formal obligation under the 2008 Code while also reporting by reference to the 2010 Code.

The Board considers that this Statement provides the information necessary to enable shareholders to evaluate how the Main Principles of the 2008 Code have been applied, that the Company has complied with the Provisions of the 2008 Code throughout the year, and that it has therefore satisfied its obligations under the 2008 Code.

To the extent that it is not specifically included in this Corporate governance statement, the information required by section 7.2 of the Disclosure Rules and Transparency Rules is included in the section entitled Other Statutory and Regulatory Information and is incorporated herein by reference.

In the interests of further transparency, we have again prepared a report which summarises the matters addressed in this Statement, as appropriate, by reference to each Principle and Provision of the 2008 Code which also refers, as appropriate, to the 2010 Code. The updated report is available on the corporate governance section of www.bat.com

The Board

The Board is collectively responsible to the Company's shareholders for the long-term success of the Group and for its overall strategic direction, its values and its governance. It provides the leadership necessary for the Group to meet its business objectives within the framework of its internal controls, while also discharging the Company's obligations to its shareholders.

Directors

As at the date of this Annual Report, the Company has a Board of 13 Directors:

Chairman

Richard Burrows

Executive Directors

Paul Adams (Chief Executive)
Nicandro Durante (Chief Executive Designate)
Ben Stevens (Finance Director and Chief Information Officer)
John Daly (Chief Operating Officer)

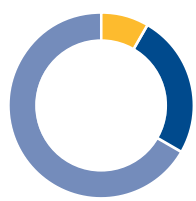
Non-Executive Directors

Sir Nicholas Scheele (Senior Independent Director)
Karen de Segundo
Robert Lerwill
Dr Ana Maria Llopis
Christine Morin-Postel
Dr Gerry Murphy
Kieran Poynter
Anthony Ruys

Paul Adams will retire from the Board and as Chief Executive on 28 February 2011. Having been appointed Chief Executive Designate on 1 September 2010, Nicandro Durante, formerly Chief Operating Officer, will succeed him as Chief Executive on 1 March 2011. John Daly was appointed as an Executive Director and Chief Operating Officer on 1 September 2010 and, on the same date, Ben Stevens took on the additional role of Chief Information Officer. Kieran Poynter was appointed to the Board as a Non-Executive Director with effect from 1 July 2010. Ana Maria Llopis will be retiring from the Board following the conclusion of the Company's Annual General Meeting on 28 April 2011.

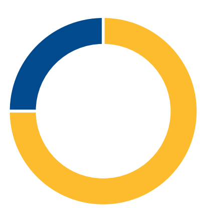
Biographical and related information about the Directors is given on the Board of Directors page.

Balance of Non-Executive Directors and Executive Directors



Length of tenure of Non-Executive Directors

Gender split of Directors



Note:
The charts above reflect the position following Paul Adams's forthcoming retirement.

Business review
Corporate governance
Financial statements
Other information

Corporate governance statement (continued)

Chairman and Chief Executive
The Chairman and Chief Executive are responsible for the profitable operation of the Group. Their roles are separate, with each having distinct and clearly defined responsibilities.

The Chairman is responsible for leadership of the Board and for ensuring its effectiveness on all aspects of its role. He sets the agenda for Board meetings in consultation with the Chief Executive and the Company Secretary. He is also responsible for ensuring that the interests of the Company's shareholders are safeguarded and that there is effective communication with them. The Chairman is accountable to the Board for leading the direction of the Group's corporate and financial strategy and for the overall supervision of the policies governing the conduct of the Group's business.

The Chief Executive has overall responsibility for the performance of the Group's business. He provides leadership to the Group to enable the successful planning and execution of the objectives and strategies agreed by the Board. He is also responsible for stewardship of the Group's assets and, jointly with the Chairman, for representation of the Group externally.

Non-Executive Directors
The role of the Non-Executive Directors is to help develop strategy and, where appropriate, to provide constructive challenge to management's proposals. They are responsible for scrutinising the performance of management in meeting agreed goals and objectives and for monitoring the reporting of performance. All of the Non-Executive Directors remain available to meet with major investors in order to understand their views and concerns.

Senior Independent Director
Sir Nicholas Scheele is the Senior Independent Director. When required, he presides at meetings of the Board and shareholders in the absence of the Chairman. He serves as intermediary for the other Directors where necessary and is available should occasion arise where there is a need to convey concerns to the Board other than through the Chairman, the Chief Executive and the other Executive Directors.

Board composition
All Directors are aware of their responsibility to take decisions objectively which promote the success of the Company for the benefit of its shareholders.

The Board considers that all of the Non-Executive Directors are independent, in the sense that they are free from any business or other relationships which could materially interfere with or appear to affect the exercise of their judgment and have not previously been involved in the management of the Group.

Kieran Poynter retired as Chairman and Senior Partner of PricewaterhouseCoopers LLP, the Company's auditors, on 30 June 2008, two years prior to his appointment to the Board. The Board specifically considered, prior to his appointment, whether his previous position with PricewaterhouseCoopers might impact upon his independence in light of Code Provision A.3.1 (B.1.1 in the 2010 Code), which identifies, as one of the circumstances which are likely, or could appear, to affect a director's judgment, any material business relationship with the Company within the previous three years. The Board took into account that Mr Poynter had neither worked with the Group nor had any responsibility for the British American Tobacco account as audit partner or otherwise during his time with the firm. Given the size and scale of PricewaterhouseCoopers as a global professional services firm, and the fact that it works with a great many businesses, the Board concluded that, in the absence of direct involvement in the Company's business, his association with the firm up to June 2008 was no impediment to its assessment of him as independent in June 2010. Mindful, however, that this could be an area of concern for shareholders, the Board decided to appoint him to the Nominations and Corporate Social Responsibility Committees only at this time. He is not currently a member of either the Audit Committee or the Remuneration Committee.

Meetings of the Board
The Board held nine meetings in 2010, seven of which were scheduled and two of which were convened to address Main Board and Management Board succession issues as a result of Paul Adams's retirement with effect from 28 February 2011. The Board is scheduled to hold seven meetings in 2011.

Board meeting attendance

Name	Meetings attended	Meetings eligible to attend
Richard Burrows	9	9
Sir Nicholas Scheele	8	9
Paul Adams	9	9
Nicandro Durante	9	9
Ben Stevens	9	9
John Daly[1]	3	3
Karen de Segundo	8	9
Robert Lerwill	9	9
Dr Ana Maria Llopis	9	9
Christine Morin-Postel	7	9
Dr Gerry Murphy	9	9
Kieran Poynter[2]	4	4
Anthony Ruys	9	9

Notes:
1. John Daly was appointed to the Board as an Executive Director and Chief Operating Officer on 1 September 2010.
2. Kieran Poynter was appointed to the Board as a Non-Executive Director on 1 July 2010.

Those Directors who were absent from one or more meetings were either unable to attend a meeting arranged at short notice or had a long-standing prior engagement.

The Chairman will always seek to obtain consensus at Board meetings but, where necessary, decisions will be taken by majority. If any Director has concerns about the running of the Company or a proposed action which cannot be resolved, such concerns will be recorded in the Board minutes. No such concerns arose in 2010.

The Non-Executive Directors, led by the Chairman, meet, if required, prior to meetings of the Board without the Executive Directors present and also meet annually, led by the Senior Independent Director, without the Chairman present.

The Board's principal responsibilities include:

- Approving the Group's business strategy and ensuring that an effective management team and the necessary financial and human resources are in place for the Group to meet its objectives.
- Agreeing the Group Budget.
- Approving the Company's Annual Report and reviewing its periodic financial reports.
- Declaring an interim dividend and recommending the final dividend.
- Agreeing the agenda for the Annual General Meeting.
- Agreeing Board succession plans and considering the evaluation of the Board's performance over the preceding year.
- Reviewing the Company's risk management and internal controls systems and governance framework and approving the Standards of Business Conduct and other Group policies.

Key activities of the Board in 2010

Growth
The Board kept under review the Group's performance throughout 2010, focusing in particular on industry trends, the outlook in strategically important markets and key consumer segments and the performance of the Group's Global Drive Brands. In doing so, it considered the global economic climate, as well as the impact on the Group's volumes of industry volume declines, growing illicit trade and foreign exchange movements, as well as specific incidents such as the floods in Pakistan. It satisfied itself throughout the year that, despite difficult trading conditions, management remained on track to deliver the strategy.

The Board regularly considered opportunities for growth through strategic acquisitions and reviewed the impact of the acquisition of the Bentoel tobacco business and its merger with BAT Indonesia effective 1 January 2010. It also considered the innovations pipeline as a driver of future growth.

It kept under review the Group's liquidity and the means by which it funds its activities and continued to satisfy itself that management was making sufficient provision in this regard.

Productivity
The Board continued to oversee initiatives aimed at managing costs, increasing efficiencies and leveraging the Group's global reach. It considered a number of short-term initiatives and reviewed progress on the longer-term Global Integration Project, aimed at achieving structural savings. A number of proposed reorganisations within the Group's regions and functions were considered during the year and are now in the process of being implemented, including a reorganisation of the Group's regions and the closure of the Group's factory in Lecce, Italy. In addition, the closure of the Group's factory in Denmark was completed.

Responsibility
The Board monitored developments in tobacco regulation around the world, including regulation being considered by the US Food and Drug Administration, the consultation on the European Tobacco Product Directive, and the likely content of the Product Guidelines being developed under the FCTC. It also kept under review the activities being undertaken within the Group's Research & Development function aimed at developing potentially reduced-harm products. It was briefed on the results of clinical trials undertaken by the Group in 2010. It also received an update on proposals to conduct extended clinical trials on further prototype products in 2011 and noted that the Group would be publishing several papers covering the results of its clinical trial studies in peer reviewed journals. The cooperation agreement entered into with the European Commission and member states of the European Union in July 2010, aimed at collectively tackling the problem of illicit trade in tobacco, was presented to the Board, and it also received an update on the FCTC Protocol on Illicit Trade.

Winning organisation
The Board reviewed succession planning in consultation with the Nominations Committee and considered and agreed the Committee's various recommendations for appointments at both Main Board and Management Board level, including those arising from the Chief Executive's forthcoming retirement. In addition, the position of the Group's major pension funds was reviewed including how the Group is managing future liabilities, and the results of the global 'Your Voice' survey of employees conducted in 2010 were considered.

The Board held one of its meetings in Russia, one of the Group's key markets, where it received presentations from members of the Eastern Europe regional team and the British American Tobacco Russia top team in Moscow and visited the factory in St Petersburg.

Corporate governance statement (continued)

Management Board

The Management Board has responsibility for overseeing the implementation by the Group's operating subsidiaries of the policies and strategy set by the Main Board, and for creating the conditions for their successful day-to-day operation. The Management Board is chaired by the Chief Executive and its other members are the Chief Executive Designate, the Finance Director, the Chief Operating Officer and the 10 senior Group executives, whose names appear on the Management Board page. It held nine scheduled meetings in 2010 and no unscheduled meetings. It is scheduled to hold nine meetings in 2011. Members of the Management Board are invited to attend meetings of the Board from time to time, in particular when the Group's strategy and Budget are under discussion.

Board Committees

The Board has established four principal Board Committees, to which it has delegated certain of its responsibilities. They are the Audit Committee, the Corporate Social Responsibility (CSR) Committee, the Nominations Committee and the Remuneration Committee. The roles, membership and activities of these Committees are described in more detail later in this Corporate governance statement and, in the case of the Remuneration Committee, in the Remuneration report. Each Committee has its own terms of reference, which have been reviewed and updated to ensure that they remain consistent with best practice and that they are aligned with the 2010 Code. The updated terms of reference were considered and adopted by the Board in December 2010 and came into effect on 1 January 2011. They are available from the Company Secretary and on www.bat.com

Conflicts of interest

The Board has formal procedures for managing compliance with the conflicts of interest provisions of the Companies Act 2006. The Company's Articles of Association permit the Board to authorise situational conflicts. Directors are required to give advance notice of any conflict issues to the Company Secretary, and these are considered either at the next Board meeting or, if the timing requires it, at a meeting of the Board's Conflicts Committee. The full Board is notified at its next meeting of any matters authorised by the Committee. In February each year, the Board reviews all previously authorised situational conflicts, considering each one afresh. Directors are excluded from the quorum and the vote in respect of any matters in which they have an interest.

During 2010, a number of situational and transactional conflicts were notified to the Company in accordance with these procedures. All matters authorised by the Board and the Conflicts Committee were recorded in the register of interests maintained by the Company Secretary. None were sufficiently significant to warrant disclosure, but included, for example, Robert Lerwill's appointment as Non-Executive Director and Audit Committee Chair of Transcom Worldwide S.A. and Kieran Poynter's appointment as Non-Executive Director of International Consolidated Airlines Group S.A.

Information and professional development

All Directors receive induction on joining the Board, covering their duties and responsibilities as directors. Non-Executive Directors also receive a full programme of briefings on all areas of the Company's business from the Executive Directors, members of the Management Board and other senior executives, and they may request such further information as they consider necessary.

All Directors receive briefings designed to update their skills and knowledge on a regular basis, for example in relation to the business and on legal and regulatory requirements, and by visits to Company sites (see Key activities of the Board in 2010). They also make use of the opportunity to attend meetings of the Group's regional audit and CSR committees. The Board timetable has been extended with effect from 2011 to allow an additional day for training or briefings on relevant matters.

Following his appointment, Kieran Poynter attended induction briefings covering the Group's strategy, its organisational structure and its business functions and activities, including its financing principles and statutory reporting cycle, environmental health & safety issues, research & development activities and legal and regulation issues. He also attended sessions addressing corporate governance and directors' duties, the Group's internal control and risk management framework and the role of the external auditors and its information technology strategy. John Daly also received a briefing on directors' duties on his appointment to the Board.

The full Board received briefings on a number of legal and regulatory developments, including the 2010 Code, the Bribery Act 2010, current trends in corporate governance and the potential impact of a change to the tax treatment of pension accruals scheduled to be introduced in April 2011.

In addition, in keeping with his enhanced responsibilities under the 2010 Code, the Chairman met separately with each Non-Executive Director in October 2010 in order to discuss individual development plans. As a result of these discussions:

- a briefing session on the Group's Research & Development activities and its operations in Southampton has been organised for June 2011;
- further briefings will be scheduled to review the Group's investment in its associate companies;
- the Group's long-term strategy is to be reviewed with the Chairman and Chief Executive during 2011; and
- a review of the progress of a project to provide enhanced IT delivery has been scheduled for the first half of 2011.

The Board and its Committees receive high-quality, up-to-date information for review in good time ahead of each meeting, and the Company Secretary, under the direction of the Chairman, ensures good information flows within the Board and its Committees and between the Non-Executive Directors and senior management. She is also responsible for advising the Board, through the Chairman, on all governance matters. The appointment and removal of the Company Secretary is a matter for the Board.

All Directors have access to the advice and services of the Company Secretary, and a procedure is in place for them to take independent professional advice at the Company's expense should this be required. The Company has arranged appropriate insurance to provide cover in the event of legal action against its Directors.

Evaluation of Board performance

The Company's approach to Board evaluation was reconsidered this year following a Board discussion of the 2010 Code and its implications for the Company's corporate governance policies and processes. Although the Company is satisfied that its previously internally conducted evaluations had been robust and thorough, it is keen to be at the forefront of good corporate governance practice. Accordingly, and consistent with its aim to meet the requirements of the 2010 Code early, the Company decided to conduct its first externally facilitated board performance evaluation during 2010.

A shortlist of possible external facilitators was prepared in July 2010. To avoid any possible conflicts of interest, no board search agencies or headhunters were included. Detailed proposals were requested from each of the candidates and a number were then interviewed by the Chairman and Company Secretary. On the basis of their proposed approach and extensive experience, Simon Osborne and Geoffrey Shepheard from the Institute of Chartered Secretaries and Administrators, were appointed to conduct a full evaluation of the performance of the Board including an overview of the work of the Committees and the performance of individual Directors.

Key areas for the review were agreed with the Chairman at the outset. These included topics for discussion proposed by the facilitators as well as those areas for improvement which had been identified in the previous year's, internally facilitated, review. Overall, seven categories were identified:

- the role of the Board, its responsibilities and those of its Committees;
- oversight, covering how the Board oversees risk, business ethics and corporate governance and the arrangements for reviewing the performance of Directors and senior managers;
- the arrangements for and effectiveness of Board meetings;
- the support and training for the Board;
- Board composition, including the range of skills required, succession planning and effectiveness of the Chairman, Senior Independent Director and Committee Chairmen;
- how the Board works together and its engagement with shareholders; and
- outcomes and achievements including how the Board is perceived externally.

Simon Osborne interviewed each of the Directors and the Chairman using a pre-defined question plan covering the agreed areas. At the end of each series of questions on a particular topic, each Director was asked to make an assessment ranging from poor through to excellent. Specific justification was requested if anyone rated a particular topic area as excellent and the interviewer also used his own experience to question and challenge the ratings given. Each interview was written up on a pro forma report and confirmed by the Director as an accurate record of the interview. The findings from the interviews formed the basis for a detailed report and presentation to the Board and a number of recommendations were made by the facilitators and discussed at the Board meeting.

While the Board discussed the effectiveness of each of the Committees in general terms, each Committee requested an opportunity to consider the findings of the Board evaluation in detail. Separate reports will be prepared for each Committee using material from the original interviews in respect of their activities. These will be considered during 2011 and any additional action points may be agreed by each Committee separately.

Comment on the personal performance of each of the Directors was provided directly to the Chairman, who then met separately with the Directors to discuss the findings of the Board evaluation, their individual performance and their personal development plan for the year ahead.

The Chairman received feedback from the Senior Independent Director, who had previously met with the other Directors to discuss the Chairman's performance using a separate discussion guide. This covered general issues relating to the effectiveness of his leadership of the Board as well as a specific issue raised by a shareholder during the year.

In addition to the formal Board Evaluation process the Chairman also discusses the effectiveness and performance of Directors immediately before they make themselves available for re-election.

Shareholder engagement

Relations with shareholders

The Board maintains a dialogue with shareholders directed towards ensuring a mutual understanding of objectives. Its primary contact, facilitated by the Head of Investor Relations, is through the Executive Directors, but the Chairman also contacts major shareholders periodically in order to understand their views on the Company and to ensure that their views are communicated to the Board as a whole. In addition, the Senior Independent Director and the other Non-Executive Directors are available to meet with major shareholders in order to understand their views and any concerns which they may have.

During 2010, a wide range of business and corporate governance issues, including Board appointments, strategy and risk, dividend policy, the share buy-back programme, the impact of currency movements and tobacco regulation, were discussed with, or raised by, a number of major institutional investors as part of the regular investor relations programme. In addition, a focused schedule of meetings with key institutional shareholders was undertaken by the Chairman in advance of the Annual General Meeting in April 2010, with discussions covering a range of issues including the Company's performance and governance generally. In addition, at the request of a shareholder, the Chairman and Senior Independent Director met with its representative to discuss particular issues relating to the Company's relationship with its external auditor, covering the appointment of Kieran Poynter and the level of non-audit fees.

Corporate governance statement (continued)

Evaluation of Board performance

Update on 2009 objectives

Specific actions arising out of the 2009 Board evaluation included:

- additional non-executive appointments;
- a review of the sequencing, timing and resourcing of the Audit and CSR Committees so that meetings of both committees could be held simultaneously;
- a review and overall assessment of Group risk to be carried out by the Board at least once a year; and
- a review of the distribution of board papers and the introduction of a board software solution.

Progress has been made on most of these objectives with some overflow into 2011. A new Non-Executive Director, Kieran Poynter, was appointed with effect from 1 July 2010 and the Board is actively seeking one or more further non-executive appointments. Mr Poynter's membership of the CSR Committee, together with the provision of additional Audit and Secretarial resources to service the Committee, have enabled meetings of the CSR Committee and the Audit Committee to be held simultaneously with effect from July 2010. This has removed a significant time pressure which existed previously for both meetings and has allowed greater flexibility to schedule appropriate training and briefing sessions on CSR and Audit matters into those Committee agendas. The Board Programme was revised to provide for an annual overview of the Group's Risk Register by the Board, again starting in July 2010. Identifying a suitable software solution for the distribution of papers has been deferred pending an assessment in 2011 of suppliers offering appropriate technology solutions.

Outcome of 2010 evaluation

The overall assessment for 2010 showed that the Board is strong and performs well. Across all seven categories the Board rated itself highly. In particular, the assessment noted the Board's focus on strategy, risk, succession, financial oversight, good governance and ethical behaviour. It is considered to be a constructive sounding board with a good spread of skills, backgrounds, gender and nationalities appropriate for a multinational business, and is considered to work well as a unit with the key relationships being sound. A number of areas for improvement were nevertheless identified in the report and have been discussed by the Board. The key actions agreed for 2011 are set out below.

- Build on the success of the revised Audit and CSR Committee arrangements by carrying out a review of the size and composition of the Remuneration Committee.
- In the interests of full transparency, ensure that the Remuneration Committee receives a formal report following the Chief Executive's annual appraisal of each member of the Management Board.
- Each of the four Committees to review the specific comments relating to their activities set out in the Evaluation Report and report back to the Board with any additional agreed action points.
- Review the current process for confirming whether Directors will be put forward for re-election, particularly in view of the requirement in the 2010 Code to submit all directors for annual re-election.
- Establish a direct reporting line for the Company Secretary to the Chairman in relation to Board matters.
- With regard to succession and, specifically the appointment of Non-Executive Directors to the Board, the Nomination Committee was reminded of the need to have particular regard to a person's ability to influence outcomes.

In addition to these key areas, a number of more administrative actions were also agreed such as a review of the calendar of standard Board items to ensure continuing relevance, periodic reviews of the content of reports to the Board, and a review of the induction arrangements to ensure all areas of the business remain covered. In addition, the remaining 2009 action point regarding a Board software solution will also be implemented.

A number of actions have already been completed, for example a direct reporting line to the Chairman has been established for the Company Secretary in relation to Board matters and the Chairman has discussed re-election with each Director as part of their development plan discussions. Other action points will be monitored through the year by way of regular reports to the Board and will be reported in next year's Annual Report.

As explained further in the Remuneration report, shareholders have been consulted regarding specific proposals in respect of the Company's Long-Term Incentive Plan and International Executive Incentive Scheme. The consultation was undertaken following the Remuneration Committee's comprehensive review in the second half of 2010 of all elements of the remuneration policy for senior managers, and was based around the Company's top 20 shareholders as well as institutional shareholder representative bodies (Association of British Insurers and the National Association of Pension Funds) and governance service agencies such as ISS. Further details of the consultation and its outcome are provided in the Remuneration report.

Analyst presentations, including those following the announcement of the preliminary results and the half-yearly report, are available by webcast, and other presentations made to institutional investors are available on www.bat.com. There is a debt microsite on www.bat.com for debt investors, which includes comprehensive bondholder information on credit ratings, debt facilities, outstanding bonds and maturity profiles.

At least twice a year, the Head of Investor Relations presents a report to the Board on investor relations generally, identifying the key issues raised by institutional shareholders. In addition, the Board receives a report at each of its meetings on any changes to the holdings of the Company's main institutional shareholders.

As part of its continuing shareholder strategy, the Company recognises the benefits of electronic communications with its shareholders. In September 2010, the Company refreshed its previous communication with shareholders to warn them about the continuing fraudulent practice of 'boiler room scams' and, in particular, unsolicited offers to sell shareholdings in the Company or to buy shares in other companies at a discount.

Annual General Meeting
The Annual General Meeting will be held at The Mermaid Conference & Events Centre, Puddle Dock, Blackfriars, London EC4V 3DB at 11:30am on 28 April 2011. Details of the business to be proposed at the meeting are contained in the Notice of Annual General Meeting which is sent to all shareholders and is also published on www.bat.com

The Annual General Meeting provides a useful opportunity for shareholder engagement and, in particular, for the Chairman to explain the Company's progress and receive questions from investors. The chairmen of the Audit, CSR, and Remuneration Committees are normally available at the Annual General Meeting to take any relevant questions and all other Directors attend, unless illness or another pressing commitment precludes them from doing so. All Directors at the time attended the Annual General Meeting in April 2010.

The Company provides for the vote on each resolution to be by poll rather than by show of hands. This provides for greater transparency and allows the votes of all shareholders to be counted, including those cast by proxy. The Chairman announces the provisional voting results at the Meeting, and the final results are announced on the same day through the Regulatory News Service and on www.bat.com. The Company appoints an independent assessor to scrutinise the Annual General Meeting and to produce a report of the meeting, covering the proxy voting process, attendance and an audit of the poll procedures. The report in 2010 confirmed the adequacy, accuracy and fairness of the proxy process and the voting procedures and systems.

Stock market listings
The ordinary shares of the Company (as British American Tobacco p.l.c.) have been listed on the Official List and traded on the main market of the London Stock Exchange for listed securities since 8 September 1998 (Share Code: BATS and ISIN: GB0002875804). This is classified as a premium listing. The share registrar is Computershare Investor Services PLC.

Since 28 October 2008, the Company's ordinary shares have had a secondary listing on the JSE Limited in South Africa (JSE), under the abbreviated name BATS and the trading code BTI. As at 31 December 2010, 246,929,672 ordinary shares of the Company (being 12.37 per cent of the Company's issued ordinary share capital – excluding treasury shares) were on its South African branch register for which Computershare Investor Services (Pty) Ltd are share registrars.

The Company's ordinary shares are also traded on NYSE Amex Equities in the form of American Depositary Receipts (ADRs) under the symbol BTI with a CUSIP number 110448107. Each ADR represents two of the Company's ordinary shares and at 31 December 2010, 28,576,280 ADRs were outstanding, represented by 57,152,560 ordinary shares. Citibank, N.A. continues to act as depositary for the ADR programme.

The Company has unlisted trading privileges for the ADR programme and none of its securities are listed on any United States securities exchange or registered pursuant to the securities laws of the United States. As a result, the Company is subject to neither the NYSE Amex Equities listing standards nor the corporate governance rules under the Sarbanes-Oxley Act of 2002. Nevertheless, the Board has chosen, in the interests of good governance, to make a voluntary statement explaining the principal differences and common areas between the Company's corporate governance practices (as explained above) and those that would be required if the Company were subject to those rules. The updated statement will be available on the corporate governance section of www.bat.com from the date of publication of the Annual Report.

Significant shareholders
At 23 February 2011, the following substantial interests (3 per cent or more) in the Company's ordinary share capital (voting securities) had been notified to the Company in accordance with section 5.1.2 of the Disclosure Rules and Transparency Rules:

Name	Number of ordinary shares	% of issued share capital
BlackRock, Inc.	132,891,526	6.65
Reinet Investments S.C.A.	84,303,670	4.22
Legal & General Group Plc	79,243,066	3.97

Note:
The percentage of issued share capital excludes treasury shares.

Corporate governance statement (continued)

Robert Lerwill
Chairman, Audit Committee

Audit Committee

Current members
Robert Lerwill (Chairman)
Christine Morin-Postel
Anthony Ruys
Sir Nicholas Scheele

Accountability and audit

Attendance at meetings in 2010

Name	Meetings attended	Meetings eligible to attend
Robert Lerwill	5	5
Christine Morin-Postel	5	5
Anthony Ruys	5	5
Sir Nicholas Scheele	4	5

Notes:
Sir Nicholas Scheele was unable to attend one meeting of the Audit Committee due to a long-standing prior engagement.
The Chief Operating Officer and the Finance Director regularly attend meetings of the Committee by invitation but are not members. The Committee's meetings are also regularly attended by the Head of Audit and Business Risk, the General Counsel to the Company and a representative of the external auditors.
Robert Lerwill has recent and relevant financial experience.
As a matter of best practice, the Committee meets alone with the external auditors at the end of every meeting and, since July 2010, it has also met separately with the Group Head of Audit and Business Risk at the end of every meeting.
Meetings were held in parallel with meetings of the CSR Committee from July 2010, allowing for longer meetings than previously and enabling fuller debate on all issues.

Summary Terms of Reference

The Audit Committee is responsible for:

- monitoring the integrity of the Group's financial statements and any formal announcements relating to the Company's performance, reviewing significant financial reporting judgments contained in them before their submission to the Board for approval;
- keeping under review the consistency of the accounting policies applied across the Group;
- reviewing the effectiveness of the accounting, internal control and business risk systems of the Company and its subsidiaries;
- reviewing and, when appropriate, making recommendations to the Board on business risks, internal controls and compliance;
- monitoring compliance with the Company's Standards of Business Conduct;
- monitoring and reviewing the effectiveness of the Company's internal audit function; and
- monitoring and reviewing the performance of the Company's external auditors, keeping under review their independence and objectivity, making recommendations as to their reappointment (or, where appropriate, making recommendations for change), and approving their terms of engagement and the level of audit fees payable to them.

The Committee's terms of reference were reviewed in December 2010 and minor updates were made with effect from 1 January 2011. The full terms of reference are available from the Company Secretary and on www.bat.com

Key activities of the Audit Committee in 2010

The Audit Committee held five meetings during 2010, at which it considered the following standing items of business:

- The Group's 2009 results and its 2010 half-yearly results and interim management statements.
- Periodic reports from the Group's regional audit and CSR committees and corporate audit committee.
- Periodic reports from the Group Head of Audit and Business Risk on international audits and the management responses and action plans being put in place to address any concerns raised.
- The 2011 Internal Audit Plan.
- Periodic reports from the Head of Group Security including consideration of security risks and frauds and losses arising during the year.
- Compliance with the Group's Standards of Business Conduct and records management procedures.
- An annual review of the external auditors' independence and a consideration of the issue on an ongoing basis (see further below).

The Committee also carried out its twice-yearly review of the Group risk register and considered the following risk topics in detail:

- Key risks arising from the FCTC and tobacco regulation, and the various actions being taken to mitigate the risk in each area.
- Key risks in certain markets, including Turkey.
- Measures being implemented to secure access to hard currency in markets with foreign exchange restrictions.
- An update on the steps being taken to enhance governance and risk management in relation to major projects and programmes, including a review of progress on the Global Integration Programme.
- The Group's manufacturing footprint and the structured process adopted in Western Europe to factory footprint reviews, including post-implementation reviews.

In addition, the Committee considered a number of other specific matters, including:

- A proposal to hold Regional Audit and CSR Committee meetings back to back so that travel time is reduced and efficiencies improved, to take effect from 1 April 2011.
- Consultations being carried out by the Auditing Practices Board and the Financial Reporting Council in connection with the type and level of non-audit services that may be provided by a company's auditor and proposed responses to the consultations on behalf of the Company.
- A review of the ratio of audit fees to non-audit fees and a consideration of the types of non-audit work carried out by the external auditors and the benefits involved in them carrying out this work (see further below).
- Oversight of the transition of the lead external audit partner, following the former lead partner's retirement by rotation.

The Audit Committee is authorised by the Board to review any activity within the business. It is authorised to seek any information it requires from, and require the attendance at any of its meetings of, any Director or member of management, and all employees are expected to cooperate with any request made by the Committee. The Committee is authorised by the Board to obtain, at the Company's expense, outside legal or other independent professional advice and secure the attendance of outsiders with relevant experience and expertise if it considers this necessary.

The Chairman of the Committee reports to the subsequent meeting of the Board on the Committee's work and the Board receives a copy of the minutes of each meeting. The papers considered by the Committee are available to any Director who is not a member, should they wish to receive them.

The Audit Committee will be reviewing comments made during the 2010 Board evaluation process in relation to its activities and any additional actions relevant to its role and responsibilities will be reported back to the Board and implemented during 2011.

Financial reporting

The Board is satisfied that it has met its obligation to present a balanced and understandable assessment of the Company's position and prospects in the Directors' report and financial statements and in periodic reports, reports to regulators and price-sensitive announcements. A summary of the Directors' responsibilities for the financial statements and their statement concerning relevant audit information is included at the end of this Corporate governance section.

Business model

The Business review includes a section outlining our business model for sustainable growth, which provides an explanation of the basis on which the Group generates value and preserves it over the long term and its strategy for delivering its objectives.

Going concern

The Group's business activities, together with the factors likely to affect its future development, performance and position are set out in the performance and strategy section and the Regional review. The financial position of the Group, its cash flows, liquidity position, facilities and borrowing position are described in the Financial Review. The Key Group risk factors include an analysis of financial risk and the Group's approach to financial risk management and notes 21 and 24 in the Notes on the Accounts provide further detail on the Group's borrowings and management of financial risks.

The Group has at the date of the report, sufficient existing financing available for its estimated requirements for the next 12 months. This, together with its proven ability to generate cash from trading activities, the performance of the Group's Global Drive Brands, its leading market positions in a number of countries and its broad geographical spread, as well as numerous contracts with established customers and suppliers across different geographic areas and industries, provides the Directors with the confidence that the Group is well placed to manage its business risks successfully in the context of current financial conditions and the general outlook in the global economy.

Corporate governance statement (continued)

Accountability and audit (continued)

After reviewing the Group's annual budget, plans and financing arrangements, the Directors consider that the Group has adequate resources to continue operating for the foreseeable future and that it is therefore appropriate to continue to adopt the going concern basis in preparing the Annual Report.

External auditors
The Audit Committee assesses annually the qualification, expertise, resources, and independence of the external auditors and the effectiveness of the audit process. The Committee's assessment is informed by an external audit satisfaction survey completed by members of senior management, which it reviews in detail.

PricewaterhouseCoopers LLP has been the Company's auditors since it listed on the London Stock Exchange in September 1998. The Audit Committee considers that the relationship with the auditors is working well and remains satisfied with their effectiveness. Accordingly, it has not considered it necessary to require the firm to tender for the audit work. There are no contractual obligations restricting the Company's choice of external auditor. The external auditors are required to rotate the audit partners responsible for the Group and subsidiary audits every five years. The current lead audit partner replaced the previous lead partner by rotation following completion of the 2009 Report and Accounts.

The Audit Committee has an established policy aimed at safeguarding and supporting the external auditors' independence and objectivity. Pursuant to this policy, it keeps under review the ratio of audit fees to non-audit fees charged by the external auditors to ensure that neither their independence nor their objectivity is put at risk. A breakdown of non-audit fees charged by the external auditors is disclosed in note 3(d) in the Notes on the Accounts. The Committee also takes steps to ensure that the external auditors do not audit their own work. In addition, during 2010, the Committee, as well as the Board, considered the specific sources of non-audit work and discussed the benefits to the Group of such work being carried out by the external auditors. In a number of instances, the Committee noted that the work had been moved to other suppliers.

The Audit Committee has completed its assessment of the external auditors for the financial period under review. It remains confident that the objectivity and independence of the external auditors are not in any way impaired by reason of the non-audit services which they provide to the Group. Moreover, the Committee is satisfied that their selection for such work is based upon an assessment of their abilities, taking into account their existing knowledge of the Group, with the majority of such work being awarded through a competitive tendering process. Having satisfied itself as to their qualification, expertise, resources and independence and the effectiveness of the audit process, it has recommended to the Board, for approval by shareholders, the reappointment of PricewaterhouseCoopers LLP as the Company's external auditors and approved their fees and terms of engagement.

Resolutions will be proposed at the Annual General Meeting on 28 April 2011 to reappoint PricewaterhouseCoopers LLP as the Company's auditors and to authorise the Directors to agree their remuneration for the 2011 audit.

Political contributions
The Audit Committee is responsible for reviewing donations made for political purposes throughout the Group. No donation was made in 2010 to any political party registered in the UK under the Political Parties, Elections and Referendums Act 2000. Subsidiaries of the Company in Australia, Canada and the Solomon Islands made contributions to non-EU political parties in their respective countries of incorporation totalling £114,245 (2009: £76,969).

Standards of Business Conduct
The Audit Committee is responsible for monitoring compliance with the Company's Standards of Business Conduct, which underpin the Company's commitment to good corporate behaviour. The Standards of Business Conduct have been in place for many years, and require all staff to act with high standards of business integrity, to comply with all applicable laws and regulations and to ensure that business standards are never compromised for the sake of results. They are currently under review in order to ensure that they remain at the forefront of best business practice and to ensure alignment with the provisions of the UK Bribery Act 2010, the offences created by which are due to come into effect during 2011.

Every Group company and every employee worldwide is expected to live up to the Standards of Business Conduct and guidance on them is communicated regularly throughout the Group, including through training and awareness programmes. All Group companies have adopted the Group Standards or local policies embodying them. They are applicable to all employees, including senior management, and to the Board of Directors. Senior managers in the Group must report on annual compliance with the Standards with regard to all employees in the company or department for which they are responsible. Information on compliance with the Standards is gathered at a global level and reported to the regional audit and CSR committees and to the Audit Committee. The CSR Committee also reviews any Group reputation-related issues arising from non-compliance with the Standards.

The Standards of Business Conduct are available from the Company Secretary and on www.bat.com

Confidential reporting procedures
The Standards of Business Conduct also set out the Group's whistleblowing policy, which enables staff, in confidence, to raise concerns about possible improprieties in financial and other matters and to do so without fear of reprisal, provided that such concerns are not raised in bad faith. The policy is supplemented by local procedures throughout the Group and at the Group's London headquarters, which provide staff with additional guidance and enable them to report matters in a language with which they are comfortable. The Audit Committee receives quarterly reports on whistleblowing incidents. It remains satisfied that the policy and the procedures in place incorporate arrangements for the proportionate and independent investigation of matters raised and for the appropriate follow-up action.

Risk management and internal control

The Board is responsible for determining the nature and extent of the significant risks that the Group is willing to take to achieve its strategic objectives and for maintaining sound risk management and internal control systems. With the support of the Audit Committee, it carries out a review of the effectiveness of the Group's risk management and internal control systems annually, covering all material controls including financial, operational and compliance controls and risk management systems, and reports to shareholders that it has done so.

During 2010, the Board considered its overall approach to risk in the context of the Group's day-to-day operations and agreed that it will continue to assess risks on a case-by-case basis, both as part of its consideration of any new proposal or strategy and in its overview of the risks and mitigating activities identified in the Group risk register.

Overview

The Company maintains its system of risk management and internal control with a view to safeguarding shareholders' investment and the Company's assets. It is designed to identify, evaluate and manage risks that may impede the achievement of the Company's business objectives rather than to eliminate these risks and can therefore provide only reasonable, not absolute, assurance against material misstatement or loss. A description of the key risk factors that may affect the Group's business is provided in the Business review.

The main features of the risk management processes and system of internal control operated within the Group are described below. They do not cover the Group's associate undertakings. They have been in place throughout the year under review and remain in place to date.

Audit and CSR committee framework

The Group's audit and CSR committee framework underpins the Board's Audit and CSR Committees. It provides a flexible channel for the structured flow of information throughout the organisation, with committees at various levels covering key individual markets, areas and the Group's regions, each referring matters to the next level as appropriate. This framework ensures that significant financial, social, environmental and reputational risks faced by the Company and its subsidiaries are appropriately managed, and that any failings or weaknesses are identified so that remedial action may be taken where necessary.

The Group's regional audit and CSR committees (which are all chaired by an Executive Director) focus on risks and the control environment within each region and are in turn supported by area and/or individual market audit and CSR committees. A corporate audit committee sits at the same level as the regional committees and focuses on the risks and the control environment within the Group's operations which do not fall within the regional committees' remit, for example, head office central functions, global programmes and above-region projects. It comprises members of the Management Board and is chaired by a Management Board member responsible for one of the Group's Regions to maximise its independence from central executive management.

The relevant external and internal auditors regularly attend meetings of these committees and have private audiences with members of the committees after every meeting. In addition, central, regional and individual market management, along with internal audit, supports the Board in its role of ensuring a sound control environment.

Risk management and internal control processes

Risk registers are used at Group, regional, area and individual market level to identify, assess and monitor the key risks (both financial and non-financial) faced by the business at each level. They are based on a standardised methodology, which was updated during 2010 to include information on prevailing trends in relation to each risk and to simplify and standardise the assessment of their impact and likelihood. Mitigation plans are required to be in place to manage the risks identified and the risk registers and mitigation plans are reviewed and, where appropriate, updated on a regular basis. Regional and above-market risk registers are reviewed regularly by the relevant regional audit and CSR committee or the corporate audit committee, as appropriate.

At Group level, specific responsibility for managing each identified risk is allocated to a member of the Management Board. The Group risk register is reviewed regularly by a committee of senior managers chaired by the Finance Director and twice-yearly by the Management Board. In addition, it is reviewed annually by the Board and twice-yearly by the Audit Committee, which also considers one or more key risks in detail at each meeting.

Group companies and other business units are required at least annually to complete a checklist of the key controls which they are expected to have in place, called Control Navigator. Its purpose is to enable them to self-assess their internal control environment, assist them in identifying any controls which may require strengthening and support them in implementing and monitoring action plans to address control weaknesses. The Control Navigator checklist is reviewed annually to ensure that it remains relevant to the business and covers all applicable key controls. In addition, at each year end, Group companies and other business units are required to:

- review their system of internal control, confirm whether it remains effective and report on any material weaknesses and the action being taken to address them; and
- review and confirm compliance with the Standards of Business Conduct and identify any material instances of non-compliance or conflicts of interest identified.

The results of these reviews are reported to the relevant regional audit and CSR committee or to the corporate audit committee and, where appropriate, to the Board's Audit Committee to ensure that appropriate remedial action has been, or will be, taken where necessary.

The Group's internal audit function provides advice and guidance to the Group's businesses on best practice in risk management and control systems. It is also responsible for carrying out audit checks on Group companies and other business units, and does so against an audit plan presented annually to the Audit Committee, which focuses in particular on higher risk areas of the Group's business. For 2011 as in 2010, the internal audit plan has been prepared on a top-down basis covering business units, global process reviews, IT as a separate unit and a focus on the continuing portfolio of projects in the Group.

Corporate governance statement (continued)

Accountability and audit (continued)

Financial reporting controls
The Group has in place a series of policies, practices and controls in relation to the financial reporting and consolidation process, which are designed to address key financial reporting risks, including risks arising from changes in the business or accounting standards. The Group Manual of Accounting Policies and Procedures sets out the Group accounting policies, its treatment of transactions and its internal reporting requirements. The internal reporting of financial information for the purpose of preparing the Group's financial statements is signed-off by the senior finance controllers responsible for the Group's markets and business units. In addition, the senior finance controllers responsible for the Group's markets and all senior managers are required to confirm annually that all information relevant to the Group audit has been provided to the Directors and that reasonable steps have been taken to ensure full disclosure in response to requests for information from the external auditors.

The effectiveness of the Group's financial reporting controls is assessed through self-certification as part of the Control Navigator exercise described above and ongoing evaluation by internal audit in the context of the annual audit plan. The integrity of the Group's public financial reporting is further supported by a number of processes and steps to provide assurance over the completeness and accuracy of the content, including:

- review by the Chairman, Executive Directors and a number of the Management Board;
- review and recommendation by the Audit Committee; and
- review and approval by the Board.

Review
The Turnbull Guidance (the Guidance) sets out best practice on internal control for UK-listed companies to assist them in assessing the application of the Code's principles and compliance with the Code's provisions with regard to risk management and internal control. The current version of the Guidance applies to listed companies for financial years beginning on or after 1 January 2006.

The processes described above, and the reports that they give rise to, enable the Board and the Audit Committee to monitor the risk management and internal control framework on a continuing basis throughout the year and to review its effectiveness at the year end. The Board, with advice from its Audit Committee, has completed its annual review of the effectiveness of the system of risk management and internal control for the period since 1 January 2010. No significant failings or weaknesses were identified and the Board is satisfied that, where specific areas for improvement have been identified, processes are in place to ensure that the necessary remedial action is taken and that progress is monitored. The Board is satisfied that the system of risk management and internal control is in accordance with the Guidance.

Karen de Segundo
Chairman, CSR Committee

CSR Committee

Current members
Karen de Segundo (Chairman)
Dr Ana Maria Llopis
Dr Gerry Murphy
Kieran Poynter

Corporate social responsibility

Attendance at meetings in 2010

Name	Meetings attended	Meetings eligible to attend
Karen de Segundo	4	4
Dr Ana Maria Llopis[1]	2	4
Dr Gerry Murphy	3	4
Kieran Poynter[2]	2	2
Sir Nicholas Scheele[3]	1	2

Notes:
1. Ana Maria Llopis will cease to be a member of the Committee following her retirement as a Non-Executive Director at the conclusion of the Annual General Meeting on 28 April 2011.
2. Kieran Poynter became a member with effect from 1 July 2010.
3. Sir Nicholas Scheele ceased to be a member with effect from 1 July 2010.

Those Committee members who were absent from one or more meetings were either unable to attend the additional meeting in April or had a long-standing prior engagement.
The Chairman, Chief Executive and the Management Board members responsible for Corporate and Regulatory Affairs and Global Operations regularly attend meetings by invitation but are not members.
Meetings were held in parallel with meetings of the Audit Committee from July 2010, allowing for longer meetings than previously and enabling fuller debate on all issues.

You can read more about our CSR at:
www.bat.com/CSR

Summary Terms of Reference

The CSR Committee is responsible for:

- reviewing and making appropriate recommendations to the Board as regards the Company's management of CSR and the conduct of business in accordance with the Statement of Business Principles;
- monitoring and reviewing the effectiveness of the Group's strategy for, and management of, significant social, environmental and reputational issues;
- reviewing and monitoring the Group's plans for, and progress towards, business sustainability; and
- monitoring the effectiveness of the CSR governance process.

The Committee's terms of reference were reviewed in December 2010 and minor updates were made with effect from 1 January 2011. The full terms of reference are available from the Company Secretary and on www.bat.com

The CSR Committee is authorised by the Board to review CSR and sustainability activity within the business. It is authorised to seek the information it requires from, and require the attendance at any of its meetings of, any Director or member of management, and all employees are expected to cooperate with any request made by the Committee. It is authorised by the Board to obtain, at the Company's expense, independent professional advice and secure the attendance of outsiders with relevant experience and expertise if it considers this necessary.

The Chairman of the Committee reports to the subsequent meeting of the Board on the Committee's work and the Board receives a copy of the minutes of each meeting. The papers considered by the Committee are available to any Director who is not a member, should they wish to receive them.

The CSR Committee will be reviewing comments made during the 2010 Board evaluation process in relation to its activities and any additional actions relevant to its role and responsibilities will be reported back to the Board and implemented during 2011.

Corporate governance statement (continued)

Corporate social responsibility (continued)

Key activities of the CSR Committee in 2010
The CSR Committee held three scheduled meetings in 2010, and one additional meeting was held at the beginning of April to approve the Company's annual Sustainability Report. The other specific items considered by it included:

CSR governance
- Feedback and update reports from the regional audit and CSR committees.
- An analysis of the results of the Control Navigator self-assessment exercise for the CSR controls.
- A review of the key reputational risks identified in the Group Risk Register, the potential impacts and consequences of such risks and the current controls in place to address them.
- A continuing review of the potential reputational impact arising from incidents of non-compliance with the Standards of Business Conduct.

CSR policies and compliance
- Human rights and related issues, including a consideration of the challenges, risks and opportunities of operating in specific countries of potential concern to stakeholders and the measures and controls in place to mitigate risks.
- Initiatives aimed at reducing the use of child labour in tobacco growing.
- Youth smoking prevention initiatives.
- Environmental, health and safety measures, including measures to improve safety culture behaviour throughout the Group.
- Adherence to the Group's International Marketing Standards.
- Corporate social investment activities and an improved approach to Corporate Social Investment (CSI) funding, with fewer initiatives but an increased average commitment per initiative, focused on the three themes of sustainable agriculture, empowerment and civic life (see further below).

Sustainability planning and reporting
- A review of the CSR Strategy and the focus in 2010 of embedding sustainability into the Group's functions and developing above-market centres of expertise to support the delivery of the sustainability agenda.
- A review of the methodology for stakeholder mapping and classification and the steps taken since 2008 to simplify the system and reduce costs.
- An assessment of the 2010 goals and commitments for sustainability reporting and progress made against the 2009 goals and commitments.
- Ernst & Young's Assurance Management report, including areas of potential improvement highlighted by them and the Company's responses to these.

CSR governance
The CSR Committee is supported at regional and local levels through combined audit and CSR committees. The structure supports the embedding of CSR and sustainability principles across the Group and allows performance against those principles to be monitored. The regional audit and CSR committees meet three times annually, and they follow a standard agenda, in order that materials and issues which are presented and raised at local and regional level may feed into Board level discussions, and vice versa.

Statement of Business Principles
Our Statement of Business Principles sets out our expectations for the responsible management of the Group's business. It was developed in 2002 in consultation with stakeholders, supported by the Institute of Business Ethics. The Statement comprises three principles – Mutual Benefit, Responsible Product Stewardship and Good Corporate Conduct – and 18 Core Beliefs which explain in more detail what each principle means for the Group. It is available from the Company Secretary and on www.bat.com

Sustainability reporting
The Company's Sustainability Reports and, prior to 2008, its Social Reports have detailed its social, ethical and environmental performance and performance against its commitments each year since the Company's first Social Report in 2002. Sustainability reporting, like the social reporting that preceded it, is conducted using a robust methodology, including independent assurance conducted by Ernst & Young LLP, in line with the AA1000 Assurance Standard (2008). Engagement with key stakeholders is a major requirement of the Standard and we have continued to hold independently facilitated and assured dialogue with those stakeholders throughout the year.

The Company's sustainability reporting is based on its sustainability agenda, which was developed in 2007 and focuses on five pillars: harm reduction, marketplace, environment, supply chain and people and culture. Its aim is to create value for the Company's shareholders and other stakeholders by addressing the Group's social, environmental and economic impacts.

Starting with the 2009 Report, produced in 2010, a single Sustainability Report has been produced for the Group, including balanced scorecards and case studies from some of the Group's largest markets. This approach, together with the information provided on www.bat.com, aims to provide comprehensive coverage of the Group's sustainability efforts globally.

In April 2010, the Company published its third Sustainability Report outlining progress in each of the five key elements of its sustainability agenda. In March 2011, it is publishing its fourth Sustainability Report, to coincide with publication of this Annual Report.

The Company has taken into account the increasing emphasis that is being placed on integrated financial and non-financial reporting. We believe that it is important to address sustainability issues in the Annual Report, but we also acknowledge that different audiences have differing expectations and requirements. As a result, we intend to continue publishing a separate Sustainability Report which covers in more detail progress against our sustainability agenda, including monitoring performance against targets. In addition to the Sustainability Report and the information provided in this Annual Report, the Company will continue to publish more detailed sustainability information on www.bat.com

The Company has been included in both the Dow Jones Sustainability World Index and the Dow Jones STOXX Sustainability Index for the ninth successive year. In 2010, the Company was again included in the Platinum sector of the UK's Business in the Community Corporate Responsibility Index, with a score of 96.5 per cent. In 2009, it was the first tobacco company to achieve Platinum status.

Corporate social investment
The Company recognises the role of business as a corporate citizen and Group companies have long supported local community and charitable projects. The Group's approach to corporate social investment (CSI) is to regard it as an end in itself, rather than as a means of promotion, and Group companies have always been closely identified with the communities where they operate.

Group companies are encouraged to focus their CSI activities around three themes:

- **Sustainable agriculture:** This includes activities such as efforts to improve biodiversity and access to water, afforestation, programmes to prevent child labour, grants for agricultural research or training to help farmers optimise land yields by growing additional (non-tobacco) crops. These initiatives are expected to complement the Group's own agricultural, environmental and biodiversity conservation practices.
- **Empowerment:** This focuses on communities where we operate, providing people with educational opportunities to help them develop, for example through scholarships and information technology training or programmes supporting small businesses and promoting entrepreneurship. Group companies also continue to make other important contributions to meet local needs, such as relief efforts after natural disasters or AIDS prevention.
- **Civic life:** This encompasses activities that aim to enrich public and community life, including supporting the arts and educational institutions, conserving indigenous cultures and restoring public spaces.

The major activities currently supported by the Company are the British American Tobacco Biodiversity Partnership and the Eliminating Child Labour in Tobacco Growing Foundation.

Charitable contributions
Payments for charitable purposes in 2010 amounted to £15.5 million (2009: £14 million), £2 million of which was paid in the UK (2009: £2 million).

OECD Guidelines
The Group recognises its responsibilities to the countries in which it operates and in this context, notes the OECD Guidelines for Multinational Enterprises in their current form.

Corporate governance statement (continued)

Richard Burrows
Chairman, Nominations Committee

Nominations Committee

Current members
Richard Burrows (Chairman)
Sir Nicholas Scheele
Karen de Segundo
Robert Lerwill
Dr Ana Maria Llopis
Christine Morin-Postel
Dr Gerry Murphy
Kieran Poynter
Anthony Ruys

Appointments to the Board

Attendance at meetings in 2010

Name	Meetings attended	Meetings eligible to attend
Richard Burrows	7	7
Sir Nicholas Scheele	7	7
Karen de Segundo	5	7
Robert Lerwill	7	7
Dr Ana Maria Llopis[1]	6	7
Christine Morin-Postel	6	7
Dr Gerry Murphy	7	7
Kieran Poynter[2]	2	2
Anthony Ruys	6	7

Notes:
1. Ana Maria Llopis will cease to be a member of the Committee following her retirement as a Non-Executive Director at the conclusion of the Annual General Meeting on 28 April 2011.
2. Kieran Poynter became a member with effect from 1 July 2010.

Those Committee members who were absent from one or more meetings were unable to attend meetings arranged at short notice.
The Chief Executive and Management Board member responsible for Human Resources regularly attend meetings by invitation but are not members.

Summary Terms of Reference
The Nominations Committee is responsible for:

- reviewing the structure, size and composition of the Main Board and Management Board to ensure that both boards have an appropriate balance of skills, expertise, knowledge and (in the case of the Main Board) independence; reviewing the succession plans for the Executive Directors and members of the Management Board;
- ensuring that the procedure for appointing new Directors is rigorous and transparent and that appointments are made on merit against objective criteria and with due regard for the benefits of diversity, including gender diversity;
- making recommendations to the Board on suitable candidates for appointment as Main Board Directors or as members of the Management Board; and
- assessing the time needed to fulfil the roles of Chairman, Senior Independent Director and Non-Executive Director, and ensuring that Non-Executive Directors undertake that they will have sufficient time to fulfil their duties.

The Committee's terms of reference were reviewed in December 2010 and minor updates were made with effect from 1 January 2011. The full terms of reference are available from the Company Secretary and on www.bat.com

The Nominations Committee reviews forthcoming retirements at least once a year and considers the need to identify candidates to fill vacancies on the Board. This process includes an evaluation of the skills and experience to be looked for in those candidates to ensure continuing Board balance. The selection process will generally involve interviews with a number of candidates, using where appropriate the services of executive search firms specialising in board level recruitment.

The Board continues to take in to account the need for it progressively to refresh its membership over time and is actively seeking one or more further Non-Executive appointments.

The Nominations Committee will be reviewing comments made during the 2010 Board evaluation process in relation to its activities and any additional actions relevant to its role and responsibilities will be reported back to the Board and implemented during 2011.

Terms of appointment to the Board
The Executive Directors have rolling contracts of one year. The Non-Executive Directors do not have service contracts with the Company but instead have letters of appointment. Details of the Company's policy on Executive Directors' service contracts and the terms of appointment for Non-Executive Directors are set out in the Remuneration report.

Key activities of the Nominations Committee in 2010

The Nominations Committee held seven meetings in 2010, two of which were scheduled and five of which were convened to address Main Board and Management Board succession issues. The specific items considered by the Committee included:

- The recruitment of Kieran Poynter and his appointment to the Board as a Non-Executive Director, with the assistance of an external executive recruitment consultancy.
- Paul Adams's retirement from the Board on 28 February 2011 and the process to select his successor as Chief Executive, including:
  - the appointment of external advisers to facilitate and assist the Committee in its assessment of potential candidates for the role of Chief Executive;
  - an updated role profile identifying the skills required for the role of Chief Executive; and
  - the results of a benchmarking exercise against the external market.
- The selection and appointment of Nicandro Durante as Chief Executive Designate.
- A consideration of the skills and experience required for the role of Chief Operating Officer, the identification of potential candidates for the role and the selection and appointment to the Board of John Daly in the role.
- The allocation of the responsibility of Chief Information Officer to Ben Stevens, in addition to his role as Finance Director.
- Further changes in the composition of the Management Board, including:
  - the appointment of David Fell as Regional Director, Asia-Pacific;
  - the appointment to the Management Board of Des Naughton in the role of Regional Director, Eastern Europe and his subsequent appointment as Group Operations Director Designate following Peter Taylor's decision to retire from the Management Board at the end of May 2011; and
  - the appointment of Andrew Gray to the extended role of Regional Director, Eastern Europe, Middle East and Africa, following the reorganisation of the Group's regions with effect from 1 January 2011.
- Continuing possible measures to refresh the Board, including further potential non-executive appointments.
- An overview of succession planning for the Executive Directors and members of the Management Board.
- A review of the general themes arising out of the Chairman's one-to-one meetings with each of the Non-Executive Directors on their personal development plans.

Directors' interests and indemnities

Further details of Directors' contracts and letters of appointment, remuneration and emoluments, and their interests in the shares of the Company (including interests in share options and deferred shares) as at 31 December 2010 are given in the Remuneration report. No Director had any material interest in a contract of significance (other than a service contract) with the Company or any subsidiary company during the year.

The Company's practice has always been to indemnify its Directors in accordance with the Company's Articles of Association and to the maximum extent permitted by law. As at the date of this report, such indemnities are in force covering any costs, charges, expenses or liabilities which they may incur in or about the execution of their duties to the Company or to any entity which is an associated company (as defined in Section 256 of the Companies Act 2006), or as a result of duties performed by the Directors on behalf of the Company or any such associated company.

Annual General Meeting 2011

In accordance with the 2010 Code, all directors of FTSE 350 companies should be subject to either election or re-election by their shareholders every year. In a change to its previous practice and to meet this requirement, all eligible Directors will be standing for re-election or, in the case of John Daly and Kieran Poynter, election for the first time, at this year's Annual General Meeting on 28 April 2011.

Chairman

Richard Burrows

Executive Directors

Nicandro Durante (Chief Executive from 1 March 2011)
Ben Stevens (Finance Director and Chief Information Officer)
John Daly (Chief Operating Officer from 1 September 2010)

Non-Executive Directors

Karen de Segundo
Robert Lerwill
Christine Morin-Postel
Dr Gerry Murphy
Kieran Poynter (from 1 July 2010)
Anthony Ruys
Sir Nicolas Scheele

The Company's Articles of Association also provide that any Director who has been appointed by the Board since the last Annual General Meeting is required to retire from the Board at the next Annual General Meeting and, being eligible, may offer himself for reappointment. Accordingly, John Daly and Kieran Poynter each retire and offer themselves for reappointment in accordance with these provisions.

Non-Executive Directors who serve for a total of more than six years are subject to a particularly rigorous review. This was done in 2010 in the case of Robert Lerwill and Sir Nicholas Scheele, both of whom will have served in excess of six years at the time of the Annual General Meeting. Additional service beyond six years is reviewed annually.

The Chairman's letter accompanying the Notice for this year's Annual General Meeting confirms that the performance of the Directors being proposed for re-election continues to be effective and that they continue to demonstrate commitment to their roles as Non-Executive Directors, including commitment of the necessary time for Board and Committee meetings and other duties. Biographical details of the Directors are also provided.

Paul Adams will retire from the Board as an Executive Director and Chief Executive on 28 February 2011. Ana Maria Llopis will retire as a Non-Executive Director at the conclusion of the Annual General Meeting.

Remuneration report

"Increasingly, the focus for remuneration is towards payment for long-term performance."

Anthony Ruys
Remuneration Committee Chairman

Introduction from the Chairman of the Remuneration Committee

Objectives

For a number of years, the principal objective of the Company's remuneration policy has been to align remuneration with the delivery of the Group's strategy of growth, productivity and the development of a winning organisation that acts responsibly at all times. We continue to see this as the right approach. As a result, relevant business objectives underpin all of the performance measures taking into account both business sustainability and the management of key risks.

The Remuneration Committee is also aware, however, that it needs to be sure that the total remuneration opportunity for the Executive Directors and senior management remains market competitive. To that end, and as indicated in the 2009 Remuneration report, a comprehensive review of all elements of senior level remuneration packages was carried out by the Committee's remuneration consultants during 2010. This included consideration of the Group's International Executive Incentive Scheme (IEIS) and the Long-Term Incentive Plan (LTIP).

Incentive Review: Overview

In undertaking this review, the Remuneration Committee was well aware of the general economic environment in which the Group continues to operate and the continuing strong performance and resilience of the Company in a challenging world. Over the long term, this is reflected in the total shareholder return of the Company of 775 per cent compared to 132 per cent for the FTSE 100 over the 10 year period to 31 December 2010. The Company has therefore performed well and the Committee is of the view that the reward structure for the Executive Directors and the members of the Management Board should reflect the quality of that performance within a framework of required motivational targets married to the usual checks and constraints relevant to a leading organisation.

Incentive Review: Outcomes

In this context, our review confirmed that, for the most part, the current remuneration works well. In particular, a single long-term performance scheme – the LTIP – continues to be appropriate in maintaining the Company's requirement for a simple and transparent, yet effective, incentive scheme. Similarly, the IEIS continues to operate effectively.

However, the Committee believes that these two areas, the LTIP and IEIS, can be improved further. In particular, the Committee is aware of the calls for remuneration to be increasingly focused towards payment for long-term performance so that the interests of shareholders and senior executives remain fully aligned. The Committee proposed changes which will firmly align reward towards long-term performance, while still remaining market competitive. In particular, it proposed to: (1) increase the maximum annual award under the LTIP scheme rules from 300 per cent to 500 per cent of annual base salary; (2) consequently increase the annual award to the Chief Executive under the LTIP to 400 per cent of annual base salary; and (3) reduce the number of common performance measures for the IEIS from six to four for 2011 onwards.

These proposals have been the subject of an extensive consultation process with key shareholders since the autumn of 2010. As a result of that dialogue and directly responding to issues raised, the Committee has agreed that: (1) the original proposal for an increase in the maximum annual award under the LTIP scheme rules from 300 per cent to 500 per cent of annual base salary be revised to 400 per cent, being consistent with the proposed award level for the Chief Executive and with no additional headroom; and (2) there should be an increase in the respective percentage amounts of salary that Executive Directors are required to hold under our shareholding guidelines. In addition, the Remuneration Committee has also proposed to introduce a clause into the LTIP scheme rules giving the Committee the discretion to reduce (or to forfeit entirely) a participant's unvested LTIP award in circumstances where there has been a material misrepresentation involving the participant in connection with a prior vested award.

The proposal for the LTIP, which I now believe has the support of a significant number of our major shareholders, will be put to all shareholders for approval at the Annual General Meeting on 28 April 2011. Separately, the IEIS proposal will be implemented during 2011. In conclusion, I am pleased with the outcomes of the review and details of the specific proposals and related matters are set out later in this report.

You can read more about our governance at:
www.bat.com/governance

Summary Terms of Reference
The Remuneration Committee is responsible for:

- determining an executive remuneration policy covering salary, performance-based variable rewards and pensions;
- determining, within the terms of the agreed policy, the specific remuneration packages for the Chairman, the Executive Directors and the members of the Management Board both on appointment and on review, having due regard to pay and employment conditions elsewhere in the Group;
- the setting and the review of targets applicable for the Company's short and long-term performance-based variable reward schemes and determining achievement against targets;
- exercising its discretion in relation to performance-based rewards (where appropriate and as provided by the applicable scheme rules); and
- monitoring and advising the Board on any major changes to the policy on employee benefit structures for the British American Tobacco Group.

Remuneration Committee

Current members
Anthony Ruys (Chairman)
Karen de Segundo
Robert Lerwill
Dr Ana Maria Llopis[1]
Christine Morin-Postel
Dr Gerry Murphy
Sir Nicholas Scheele

Note:
1. Ana Maria Llopis will cease to be a member of the Remuneration Committee following her retirement as a Non-Executive Director at the conclusion of the Annual General Meeting on 28 April 2011.

At the date of this report, the Committee comprises independent Non-Executive Directors of the Company set out in the table above. There were no changes in the membership of the Remuneration Committee during 2010.

The Secretary to the Committee is Nicola Snook, the Company Secretary.

Attendance at meetings in 2010

Name	Meetings attended	Meetings eligible to attend
Anthony Ruys	6	7
Karen de Segundo	6	7
Robert Lerwill	7	7
Ana Maria Llopis	6	7
Christine Morin-Postel	5	7
Gerry Murphy	7	7
Sir Nicholas Scheele	7	7

Note:
Those Directors who were absent from one or more meetings of the Committee were either unable to attend a meeting arranged at short notice or had a long-standing prior engagement.

No Executive Director or Management Board member plays any part in determining his or her remuneration. During the year ended 31 December 2010, both the Chief Executive and the Chairman were consulted and invited to attend meetings of the Committee, except when their own remuneration was under consideration. In determining remuneration for the year, the Committee considered a report from Deloitte LLP, the Committee's remuneration consultants, and also consulted the Chief Executive and the member of the Management Board responsible for Human Resources and the Group Head of Reward.

The agenda for the meetings of the Remuneration Committee is agreed by the Chairman of the Remuneration Committee, taking into account the views of other members of the Committee, as appropriate.

The Committee's terms of reference were reviewed in December 2010 and minor updates were made with effect from 1 January 2011. The full terms of reference are available from the Company Secretary and on www.bat.com/governance

The Remuneration Committee is authorised by the Board to seek any information it requires from, and require the attendance at any of its meetings of, any Director or member of management, and all employees are expected to cooperate with any request made by the Committee. The Committee is authorised by the Board to obtain, at the Company's expense, outside legal or other independent professional advice if it considers this necessary. In particular, the Committee is responsible for the appointment of any remuneration consultants who may advise the Committee.

Deloitte LLP provided remuneration services and advice to the Remuneration Committee throughout the year. Deloitte is an international professional services firm which has also supported management in the development and delivery of remuneration proposals as well as the provision of tax, corporate finance and consulting services to British American Tobacco Group companies around the world. Herbert Smith LLP has also been retained by the Company to provide legal advice in respect of the Company's share schemes, as well as providing other legal services to British American Tobacco as a whole. Ernst & Young LLP provides tax advice to international assignees and in respect of the Company's share schemes.

Following the 2010 Board evaluation, the Remuneration Committee will be reviewing its size and composition during 2011. It will also be reviewing comments made during the evaluation process in relation to its activities and any additional actions relevant to its role and responsibilities will be reported back to the Board and implemented during 2011.

Remuneration report (continued)

Key activities of the Remuneration Committee in 2010
The Remuneration Committee met seven times during 2010. The Committee followed its regular work programme designed around its two scheduled meetings in February and October each year at which it:

- benchmarked, reviewed and set the salaries for the Executive Directors and the Management Board members;
- assessed the achievement of the targets for the 2009 IEIS award and set the IEIS targets for 2010;
- assessed the measurement of the performance conditions for the vesting of the Long-Term Incentive Plan (LTIP) 2007 award;
- determined the LTIP award for March 2010 and its associated performance conditions;
- assessed the achievement of the targets for the 2009 Share Reward Scheme award and set the targets for the award made in 2010;
- monitored the application of the Company's shareholding guidelines for the Executive Directors and the Management Board members;
- maintained oversight of the Group's salary review processes to ensure consistency of application; and
- reviewed the Remuneration report for the year ended 2009 prior to its approval by the Board and subsequent approval by shareholders at the Annual General Meeting in April 2010.

In addition, the Remuneration Committee dealt with the following:

- a comprehensive review of the Company's remuneration packages over two Committee meetings, culminating in the proposed changes to the LTIP and IEIS as explained elsewhere in this report;
- the application of the Group's policies in connection with the retirement arrangements for Paul Adams as Chief Executive;
- terms of appointment for Nicandro Durante as Chief Executive Designate and John Daly as Chief Operating Officer;
- the revised remuneration package for Ben Stevens (Finance Director) to reflect his additional responsibilities as Chief Information Officer;
- terms of appointment and termination in connection with Management Board appointments and departures during the year particularly with regard to the reorganisation of the Group's regional structure; and
- the impact of forthcoming changes to the tax treatment of pension contributions made by or on behalf of UK employees into a UK pension.

Remuneration policy

Group reward strategy
It is important that the remuneration policy for the Executive Directors and the members of the Management Board considered by the Committee is placed in the context of the strategy for rewards and benefits for employees across the Group. As a leading global business, British American Tobacco wants its employees to feel rewarded by the challenge of their roles, their career opportunities and positive team relationships. The reward strategy is positioned to support the goal of attracting and retaining the best people for the organisation.

Regular benchmarking exercises are carried out across the Group in order to provide comparative data to ensure the provision of reward and benefit structures in keeping with local market practice while being clearly linked to aligned individual and organisation performance objectives. Economic factors are considered and salary surveys are conducted in individual markets to compare the Group company remuneration packages against those of comparator companies, while ensuring that these are aligned to a global reward philosophy and approach.

Executive Directors and Management Board: remuneration policy
The remuneration policy for the Executive Directors and members of the Management Board is also considered by the Remuneration Committee with reference to the Company's strategic vision and analysis of risk and its associated systems (see risk management and internal control in the Corporate governance statement). The aim is to support the Company's strategy by linking the relevant performance criteria of the remuneration packages with the key performance indicators (KPIs) and business measures (see Business review).

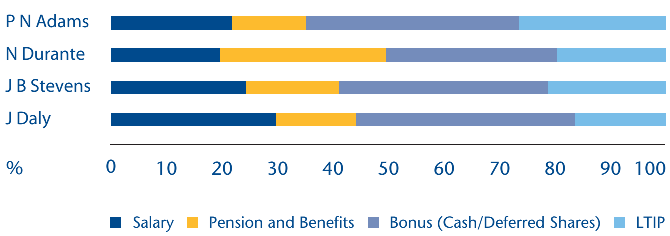
Financially based KPIs form the basis for the majority of the performance-related bonus incentives with market share being an important additional non-financial indicator. The Executive Directors and the members of the Management Board are also held accountable for their performance in respect of the business measures which comprise a mixture of other financial and non-financial targets.

Taken together, these elements provide a comprehensive set of challenging performance criteria which sit alongside the Company's positive position on sustainability and governance issues. The remuneration policy reflects the Company's objectives which are linked to the payouts and grants under the respective incentive schemes. This promotes the Group's ability to attract, retain and motivate top quality executives, enabling the Group to achieve the levels of corporate performance in alignment with the long-term interests of the Company and its shareholders.

Further, the Remuneration Committee has set a guideline that approximately 50 per cent of the remuneration package should be performance-related. The remuneration package comprises both core fixed elements (base salary, pension and other benefits) and performance-based variable elements (cash and share incentive annual bonus plans, and the LTIP).

The composition in the case of the current Executive Directors for 2010 is illustrated in the bar chart below:

Executive Directors' percentage of fixed and variable remuneration



Notes:
1. The above illustration of the Executive Directors' percentage of fixed and variable remuneration for 2010 is based on a number of assumptions: (1) base salary represents annual salary; (2) pension represents the transfer value of net increase in pension to the UK Pension Fund as disclosed in Table 7 (Nicandro Durante's transfer value is based on constant exchange rates); (3) benefits are core benefits such as car allowance, private medical and personal accident insurance; (4) bonus is the amount received for performance in 2010 delivered in cash and deferred shares; (5) LTIP represents the target annualised expected value of the long-term incentive award granted in 2010 expressed as a percentage of base salary; and (6) the remuneration shown for John Daly for 2010 includes eight months as a member of the Management Board prior to his appointment as an Executive Director on 1 September 2010.
2. Fixed remuneration comprises: salary, pension and benefits. Variable remuneration comprises: bonus (cash and deferred shares) and LTIP.

Pay Comparator Group

The setting of the reward opportunity for Executive Directors remains underpinned by responsible independent benchmarking. The approach is focused on a peer group which includes selected FTSE 100 companies and, since 2009, Philip Morris International (the Pay Comparator Group), which is supplemented by market data of FTSE 350 companies, with the relevant scale and complexity, as well as the practice of the FTSE 30 companies. The Pay Comparator Group is made up of companies which meet the criteria of a consumer goods focus, an international spread of operations and a competitor for top management talent.

In February 2010, Cadbury, a former constituent company of the Pay Comparator Group, was taken over by Kraft Foods. Cadbury is therefore removed from the Pay Comparator Group and, as at 31 December 2010, it is comprised as follows:

Associated British Foods	Philip Morris International
AstraZeneca	Reckitt Benckiser
BP	Reed Elsevier
BT Group	Royal Dutch Shell
British Sky Broadcasting	SABMiller
Diageo	Tesco
GlaxoSmithKline	Unilever
Imperial Tobacco Group	Vodafone
Marks & Spencer	WPP Group
Pearson	

Salary

Purpose	– reward individual performance – reflect skills and experience
Delivery	– monthly – cash
Policy	– annual review in February (with salary changes effective from April) or ad hoc review on a significant change of responsibilities – benchmarked for appropriate salary levels using a company size and complexity model coupled with: (1) the Pay Comparator Group; and, for Executive Directors, (2) published salary data for FTSE 350 companies – base salary is pensionable
Incentive Review	– no change to policy

The summary table above sets out the key policy principles for the salaries for the Executive Directors and the Management Board members. Similar principles are applied to the salaries of senior managers and other levels in the organisation, taking into account local market practices across the Group.

Remuneration report (continued)

	Base salary from 1 April 2011 (or applicable date) £	Base salary at 1 January 2011 £	Base salary from 1 April 2010 £
Paul Adams (Chief Executive until 28 February 2011)	–	1,290,000	1,290,000
Nicandro Durante (Chief Executive from 1 March 2011)	1,000,000	1,000,000	670,000
Ben Stevens (Finance Director and Chief Information Officer)	750,000	720,000	640,000
John Daly (Chief Operating Officer from 1 September 2010)	650,000	650,000	–

Paul Adams will retire as an Executive Director and as Chief Executive with effect from 28 February 2011.

Nicandro Durante, formerly Chief Operating Officer, was appointed Chief Executive Designate on 1 September 2010 and in this context his base salary was increased to £1,000,000 with effect from 1 January 2011 prior to his becoming Chief Executive on 1 March 2011. Under the terms of his service contract, Nicandro Durante's base salary is not subject to an annual review until April 2012.

John Daly was appointed as an Executive Director and Chief Operating Officer with effect from 1 September 2010 with a base salary of £650,000. Ben Stevens, as Finance Director, assumed additional responsibilities as Chief Information Officer, with effect from 1 September 2010 with a new base salary of £720,000. He will receive an increase in base salary of 4.1 per cent (£30,000) from 1 April 2011.

The Management Board members will receive salary increases averaging around 4.1 per cent; centre-based UK employees will receive salary increases averaging around 4 per cent with effect from 1 April 2011. Actual rises have been based on each individual's contribution and performance as well as to ensure market competitiveness.

In addition to basic salary, the Executive Directors receive certain benefits in kind, principally: a car or car allowance; the use of a driver; the installation and/or maintenance of home security systems and private medical and personal accident insurance.

Performance-related bonus – International Executive Incentive Scheme (IEIS)

Purpose	– incentivise the attainment of corporate targets on an annual basis
Delivery	– annual award – 50 per cent cash – 50 per cent shares (deferred shares through the Deferred Share Bonus Scheme) – dividend equivalent payment
Policy	– six common measures for performance during 2010 with equal weightings: adjusted profit from operations; market share; Global Drive Brand volume; net revenue; cash flow; and costs – the annual 'on-target' bonus opportunity for the Chief Executive is 100 per cent of base salary with a maximum award of 200 per cent of salary, and for the Chief Operating Officer and the Finance Director and Chief Information Officer the 'on-target' bonus opportunity is 90 per cent with a maximum award of 180 per cent – for the Management Board the 'on-target' bonus opportunity is 67.5 per cent of the base salary with a maximum award of 135 per cent of salary – awards are non-pensionable
Incentive Review	– structure and potential bonus opportunity remain unchanged – four common measures for performance from 2011 (reduced from six) with the following weightings: adjusted profit from operations (40 per cent); market share (20 per cent); Global Drive Brand volume (20 per cent); and cash flow (20 per cent)

The IEIS rewards short-term business performance within the context of longer-term sustainability. Appropriately stretching business and financial performance targets are set by the Remuneration Committee at the beginning of each year. In 2010, there were six common measures as referred to above with each having an equal weighting of 16.67 per cent. Relevant performance points are: threshold (which must be exceeded to attract any payment of a bonus for that measure); target; and maximum amount (the level at which the bonus for that measure is capped). These performance points are set at the start of the year by reference to the Group's annual budget. No elements of the bonuses are guaranteed and, as in previous years, the specific performance points are commercially sensitive and not made public.

For the Executive Directors and Management Board members, the annual bonus opportunity for 2011 (unchanged from 2010) will be as shown in the summary table above. The annual bonus opportunity for senior managers also remains unchanged with the annual 'on-target' bonus opportunity being 45 per cent of base salary with a normal maximum award of 90 per cent of salary rising to 135 per cent of base salary in cases of exceptional performance. The award for senior managers is delivered in variable proportions according to grade, being usually 55 per cent cash and 45 per cent deferred shares.

For 2011, the six measures will be reduced to four as stated under the Incentive Review section of the table above. These four performance measures provide a simplified and appropriate mix of criteria that look to assess the vitality and performance of the Company while still providing full clarity for both shareholders and eligible participants about the required areas of performance.

The Committee receives a report to allow it to assess the extent to which performance measures have been achieved. Subject to the Committee exercising its judgment in the assessment of the quality of the Company's overall performance, the payout for each measure is determined by reference to performance relative to that measure's performance points, on a pro rata basis.

In respect of the year ended 31 December 2010, the total payouts under the IEIS were:

Payout: 50 per cent in cash, 50 per cent in deferred shares	2010 %	2009 %
Paul Adams (Chief Executive until 28 February 2011)[1]	**173.9**	135.4
Nicandro Durante (Chief Executive Designate from 1 September 2010)	**156.5**	121.9
Ben Stevens (Finance Director and Chief Information Officer)	**156.5**	121.9
John Daly (Chief Operating Officer from 1 September 2010)[2]	**156.5**	–
Management Board members	**117.4**	91.4

Notes:
1. Paul Adams will retire as Chief Executive on 28 February 2011 and will cease to be an employee of the Company from that date. In accordance with the rules of the IEIS, his performance-related bonus in respect of the year ended 31 December 2010 is therefore payable as a 100 per cent cash bonus instead of 50 per cent in cash and 50 per cent in deferred shares.
2. The percentage payout shown for John Daly reflects the percentage applicable for the period since his date of appointment as an Executive Director on 1 September 2010.
3. The actual performance-related payments are shown in Table 4 – annual cash bonus and deferred share bonus.

For senior managers, the total payouts reflect performance at a global, regional, area or end market level, as applicable to their roles. For senior managers whose bonus was linked to global performance, the total payout under the IEIS in respect of the year ended 31 December 2010 was 96.9 per cent (2009: 60.9 per cent), paid 55 per cent in cash and 45 per cent in deferred shares.

Awards made under the Deferred Share Bonus Scheme are in the form of free ordinary shares in the Company which are normally held in trust for three years and no further performance conditions apply in that period. This element of 'reward deferral' has been a key element of the Company's bonus structure for a number of years and, in certain circumstances, such as resigning before the end of the three year period, participants may forfeit the shares. The Remuneration Committee encourages a culture of 'ownership' of these awarded shares and participants receive a cash sum equivalent to the dividend on the after-tax position of all unvested ordinary shares held in the Deferred Share Bonus Scheme at the dividend record date.

Long-term incentives

Purpose	– incentivise growth in earnings per share and total shareholder return (TSR) over a three year period
Delivery	– discretionary annual award – awards of shares – variable due to performance over three year period – dividend equivalent payment
Policy	– maximum annual award of 300 per cent of salary – three year performance period – TSR performance (50 per cent of the total award) combines both the share price and dividend performance during the three year performance period as against two comparator groups (25 per cent for each measure): (1) constituents of the FTSE 100 Index; and (2) a peer group of FMCG companies – earnings per share measure (50 per cent of the total award) relates to earnings per share growth (on an adjusted diluted basis) relative to inflation
Incentive Review	– subject to shareholder approval, the maximum annual award under the LTIP scheme rules will be increased from 300 per cent to 400 per cent of annual base salary and LTIP awards made in 2011 will be made at 400 per cent of annual base salary for the Chief Executive and at 300 per cent for the other Executive Directors – as shareholder approval is required, a resolution and an explanatory appendix are set out in the Notice of Meeting for the AGM on 28 April 2011 – the introduction of a discretionary power to reduce/forfeit unvested awards in the event of material misrepresentation – all other elements of the LTIP remain unchanged

The long-term element of remuneration continues to be delivered through the Company's LTIP. All the Executive Directors, Management Board members and senior employees participate in the Long-Term Incentive Plan adopted in 2007 (the 2007 LTIP). This plan replaced the LTIP adopted in 1998 (1998 LTIP) under which no further awards have been made and which has now expired, although there is a small number of participants who remain to exercise their awards under that plan. The 2007 LTIP provides for awards of free ordinary shares, provided demanding and appropriately stretching performance conditions are met over a three year period.

Remuneration report (continued)

Award levels

The award levels for Executive Directors and Management Board members are set out in the table below and have been applied to awards made from 2008 to 2010. Senior managers receive awards of 75 per cent or 25 per cent of salary dependent on grade.

LTIP awards	Multiple of base salary %
Chief Executive	300
Finance Director and Chief Information Officer	250
Chief Operating Officer	250
Management Board	200

If approved by shareholders at the forthcoming Annual General Meeting, an LTIP award of 400 per cent will be made to the Chief Executive (currently the Chief Executive Designate) in May 2011. At the same time, the Finance Director and Chief Information Officer and the Chief Operating Officer will receive awards at 300 per cent of base salary. These new award levels reflect the key outcome of the review in 2010: the re-balancing of total remuneration packages for Executive Directors towards rewarding long-term, sustainable performance.

Awards to members of the Management Board will remain at the 2010 level of 200 per cent of base salary and these will also be made in May 2011. Awards for the senior managers will be made in March 2011 at the same levels as in 2010.

Since 2005, participants have been entitled to receive a dividend equivalent payment to the value of the dividends that they would have received as shareholders on their vesting awards. The LTIP dividend equivalent payment continues to be important in aligning further the interests of senior management with those of shareholders. The values of the LTIP dividend equivalent payments for the Executive Directors are shown as individual emoluments in Tables 3 and 4.

To the extent that the performance conditions have been satisfied following assessment by the Remuneration Committee, awards are normally exercisable between three and 10 years after they have been made. An award of shares lapses to the extent that the performance conditions are not satisfied in accordance with the measures set out above at the end of the three year performance period. Further, any such proportion of the award that lapses, as a result, does not attract the payment of the LTIP dividend equivalent payment.

Performance

The percentage of award vesting is based on a combination of total shareholder return (TSR) and earnings per share (EPS) performance conditions measured over a three year period. The Remuneration Committee considers that both of these measures are appropriate benchmarks of a company's performance. This combination provides an important balance of measures relevant to the Group's business and market conditions as well as providing a common goal for the Executive Directors, the Management Board members and shareholders. These performance conditions are set out in the above table and are considered in more detail below.

TSR performance condition

A total of 50 per cent of the total award is based on the Company's TSR performance against two comparator groups (25 per cent for each measure): (1) the constituents of the London Stock Exchange's FTSE 100 Index at the beginning of the performance period; and (2) a peer group of international FMCG companies. In the event of upper quartile performance by the Company relative to the comparator groups above, 25 per cent of the total award vests in full. From 2008, 6 per cent of the total award vests for median performance. There is pro rata vesting between these two points. The TSR portions of an LTIP award do not vest for below median performance.

These comparator groups, which are regularly reviewed to ensure that they will remain both relevant and representative, are chosen to reflect the Company's financial and business trading environments.

The applicable FMCG peer groups for the outstanding LTIP awards are shown below.

FMCG Peer Group	Award: 27 March 2010	Award: 15 March 2009	Award: 15 May 2008
Anheuser-Busch			✓
Anheuser-Busch InBev	✓	✓	
Cadbury		✓	
Cadbury Schweppes			✓
Campbell Soup	✓	✓	✓
Carlsberg	✓	✓	✓
Coca-Cola	✓	✓	✓
Colgate-Palmolive	✓	✓	✓
Danone (formerly Group Danone)	✓	✓	✓
Diageo	✓	✓	✓
The Gillette Company			✓
Heineken	✓	✓	✓
HJ Heinz	✓	✓	✓
Imperial Tobacco Group	✓	✓	✓
InBev SA			✓
Japan Tobacco	✓	✓	✓
Johnson & Johnson	✓	✓	✓
Kellogg	✓	✓	✓
Kimberly-Clark	✓	✓	✓
Kraft Foods	✓		
LVMH	✓	✓	✓
Nestlé	✓	✓	✓
PepsiCo	✓	✓	✓
Pernod Ricard	✓	✓	✓
Philip Morris International [1]	✓	✓	✓
Procter & Gamble	✓	✓	✓
Reckitt Benckiser	✓	✓	✓
SABMiller	✓	✓	✓
Sara Lee	✓	✓	✓
Unilever	✓	✓	✓
Wrigley			✓

Note:
1. For the 2008 award, Altria Group was tracked from the start of the performance period and then re-invested in Philip Morris International from the point of demerger.

TSR continues to be measured according to the return index calculated by Datastream and reviewed by the Company's independent advisers. It is measured on the basis that all companies' dividends are reinvested in the shares of those companies. The return is the percentage increase in each company's index over the three year performance period. The opening and closing indices for this calculation are respectively the average of the index numbers for the last quarter preceding the performance period and for the last quarter of the final year of that performance period – this methodology is employed to reflect movements of the indices over that time as accurately as possible.

A local currency basis is used for the purposes of TSR measurement. This approach is considered to have the benefits of simplicity and directness of comparison with the performance of the comparator companies, and is in line with the historic approach taken by the Remuneration Committee for the purposes of TSR measurement.

EPS performance condition

Half of the award is based on earnings per share growth relative to inflation. This element of the award will vest in full if EPS growth over the three year performance period is an average of at least 8 per cent per annum in excess of inflation. Eight per cent of the award will vest if the EPS growth over the performance period is 3 per cent in excess of inflation. An award will vest on a pro rata basis between these two points. None of the EPS portion of an award vests if EPS growth is less than 3 per cent per annum in excess of inflation.

These EPS targets are consistent with and support the Company's strategy to deliver high single-digit EPS growth (on average) over the medium to long term. The Remuneration Committee reviewed the EPS targets as part of the Incentive Review and concluded that the current targets continue to be appropriately stretching.

For awards made up to and including 2008, growth in EPS for these purposes is calculated on an adjusted diluted EPS basis using a formula which incorporates: (1) the adjusted diluted EPS for the year prior to the start of the first performance period and then for the first, second and third years of that performance period; and (2) retail price index (RPI) for the last month of the year immediately preceding the performance period and then the RPI for the respective first, second and third years of that performance period.

Since the LTIP award made in March 2009, EPS performance is measured as an increase in adjusted diluted EPS between the base year and the final year of the performance period, expressed as an annual growth rate over the period. Under this approach, only the base year and final year adjusted diluted EPS results are considered. However, on the basis that rolling annual awards are made, all years of performance ultimately will be taken into account in calculating EPS growth over time. This change was made in order to simplify the approach and to bring it into line with prevailing market practice. Where EPS grows at a relatively constant rate, the two methodologies will produce broadly similar results, although the outcome will differ for different growth profiles. Both methods are considered to be fair and reasonable measures of performance.

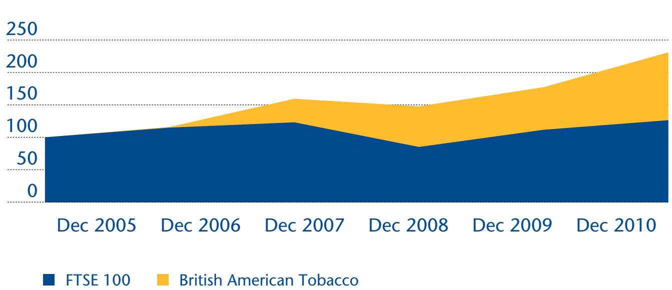
Remuneration report (continued)

Vesting of LTIP award made in 2008
An LTIP award was made to Executive Directors and Management Board members on 15 May 2008 with the performance period being completed at 31 December 2010 (the 2008 Award). The Remuneration Committee has assessed the performance of the Company against the two performance conditions. On the TSR measure, the Company ranked 12th out of the FTSE 100 group of companies, giving a vesting of 25 per cent for performance at the upper quartile. A vesting of 25 per cent was also achieved for ranking second out of the peer group of international FMCG companies, this also being upper quartile. EPS growth was 15.9 per cent per annum in excess of inflation. The overall assessment of both LTIP measures, therefore, resulted in a vesting of 100 per cent of the award.

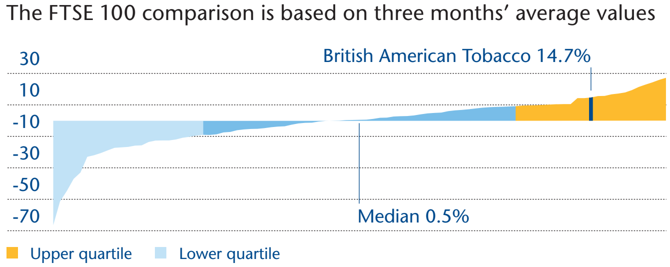
In accordance with the rules of the 2007 LTIP, the Remuneration Committee also resolved that the participants would receive an LTIP dividend equivalent payment on the vesting of their 2008 awards.

Performance graph
Schedule 8 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 requires that the Company must provide a graph comparing the TSR performance of a hypothetical holding of shares in the Company with a broad equity market index over a five year period. In this context, the Directors have again chosen to illustrate the performance of TSR against the FTSE 100 Index over a five year period, commencing on 1 January 2006. In the opinion of the Directors, the FTSE 100 Index is the most appropriate index against which TSR should be measured because it is a widely used and understood index of broadly similar sized UK companies to the Company. The performance graph is shown below.

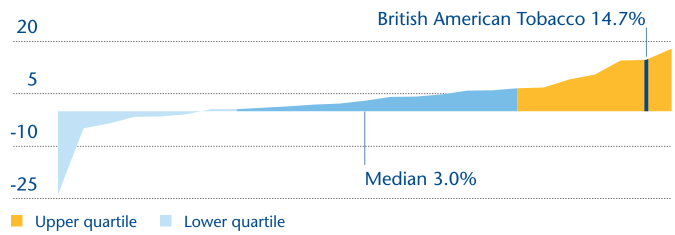
Historical total shareholder return performance
Growth in the value of a hypothetical £100 holding over five years
FTSE 100 comparison based on 30 trading day average values



Total shareholder return (annual %)
FTSE 100 – 1 January 2008 to 31 December 2010
The FTSE 100 comparison is based on three months' average values



Total shareholder return (annual %)
FMCG group – 1 January 2008 to 31 December 2010
The FMCG group comparison is based on three months' average values



LTIPs – change of control
The rules of the 1998 LTIP and the 2007 LTIP both provide that in the event of a change of control of the Company as a result of a takeover, reconstruction or winding up of the Company (not being an internal reorganisation), LTIP awards will become exercisable for a limited period based on the period of time which has elapsed since the date of the award and the achievement of the performance conditions at that date, unless the Remuneration Committee determines this not to be appropriate in the circumstances. In addition, the 2007 LTIP allows (as an alternative to early release) that participants may, if permitted, exchange their LTIP awards for new awards of shares in the acquiring company on a comparable basis.

Share Option Scheme
No options have been granted under the Share Option Scheme since March 2004 and no options have been granted to the current Executive Directors since September 1999. The Share Option Scheme expired in April 2008. As at 31 December 2010, no Executive Directors held outstanding options under the Share Option Scheme.

During the life of the Share Option Scheme, options granted were not issued at a discount to the market price at the time of grant, with the value of options for that grant being limited to 50 per cent of a participant's base salary. All outstanding options have matured and are exercisable up to March 2014.

All-employee share schemes
The Executive Directors, Management Board members and senior managers are also eligible to participate in the following all-employee share schemes which are designed to incentivise employees of the Group by giving them opportunities to build a shareholding in the Company: the British American Tobacco Sharesave Scheme (Sharesave Scheme) and the Employee Share Ownership Plan.

Sharesave Scheme
The Sharesave Scheme is approved by HM Revenue & Customs (HMRC). Eligible employees, including the Executive Directors and Management Board members, have been granted employee savings-related share options to subscribe for ordinary shares in the Company. Grants of options under the Sharesave Scheme have historically been made in November each year. However, during 2010 the Company reviewed its timetable for making grants of options under the Sharesave Scheme with the result that no grants were made in that year. Instead, the Company intends to make its

next grant of options under the Sharesave Scheme in March 2011 following the 2010 Preliminary announcement. Options will be granted to be exercisable in conjunction with either a three year or five year savings contract up to a monthly limit of £250. Options are normally granted at a discount of 20 per cent to the market price at the time of the invitation, as permitted under the rules of the Sharesave Scheme. At 31 December 2010, Nicandro Durante and Ben Stevens each held options under the Sharesave Scheme.

Employee Share Ownership Plan
The Employee Share Ownership Plan is an HMRC approved share incentive plan, which incorporates a Partnership and Free Shares element. The Partnership Share Scheme is open to all eligible employees, including Executive Directors and Management Board members. Employees can allocate part of their pre-tax salary to purchase shares in the Company. The maximum amount that can be allocated in this way is £1,500 in any year. Shares purchased are held in a UK-based trust, normally capable of transfer to participants tax-free after a five year holding period. At 31 December 2010, Paul Adams and Nicandro Durante participated in the Partnership Share Scheme.

The Company also operates the Free Shares element of the plan, known as the Share Reward Scheme. Under this Scheme, eligible employees (including Executive Directors and members of the Management Board) receive an award of shares in April of each year in which the Scheme operates in respect of performance in the previous financial year. An award of £2,610 will be made to Executive Directors and Management Board members on 1 April 2011 in respect of the year ended 31 December 2010. The performance conditions are aligned to those set for the IEIS in respect of the same performance period. The plan shares are held in a UK-based trust for a minimum period of three years and during that time the trust will exercise its voting rights as directed by the plan's participants. The maximum individual award under the Share Reward Scheme is £3,000.

Options and awards outstanding

To satisfy the future exercise of awards or options under the Group's employee share schemes, ordinary shares are acquired in the market by the Group's employee share ownership trusts or the Company issues new shares.

During the year, new ordinary shares were issued by the Company in relation to the Sharesave Scheme and to certain participants in the Share Option Scheme resident outside the UK.

Under the Sharesave Scheme, a total of 881,981 options over ordinary shares in the Company were outstanding at 31 December 2010. The options outstanding under the Sharesave Scheme are exercisable until June 2015 at option prices ranging from 977p to 1,555p.

The British American Tobacco Group Employee Trust (BATGET)
BATGET is used to satisfy the vesting and exercise of awards of ordinary shares made under the Deferred Share Bonus Scheme, and the 1998 LTIP and the 2007 LTIP as well as the exercise of options under the Share Option Scheme. The number of shares held in BATGET to satisfy outstanding awards is consistently monitored by a committee of senior management that reports to a committee of the Board. BATGET is funded by interest-free loan facilities from the Company totalling £400 million, enabling the trust to facilitate the purchase of ordinary shares to satisfy the future vesting or exercise of options and awards. The loan to BATGET amounted to £325 million at 31 December 2010 (2009: £273 million). The loan is either repaid from the proceeds of the exercise of options or, in the case of ordinary shares acquired by BATGET to satisfy the vesting and exercise of awards, the Company will subsequently waive the loan provided over the life of the awards. If the options lapse, ordinary shares may be sold by BATGET to cover the loan repayment.

BATGET currently waives dividends on the ordinary shares held by it. As at 31 December 2010, BATGET held 11,949,088 ordinary shares with a market value of £294.4 million (1 January 2010: 14,679,045 ordinary shares; £296.0 million), being 0.59 per cent of the Company's issued ordinary share capital (1 January 2009: 0.72 per cent) (including treasury shares). BATGET waived payment of the final dividend for 2009 of £9.9 million in May 2010 and the interim dividend for 2010 of £4.1 million in September 2010.

While shares are held by BATGET, the trustee does not exercise any voting rights. However, as soon as shares held in BATGET are transferred out to share scheme participants, the participants may exercise the voting rights attaching to those shares.

Details of the Company's material share-based payment arrangements, reflecting both equity share-based and cash-settled share-based arrangements, are set out in note 27 to the accounts.

Shareholding guidelines

Executive Directors and Management Board members are encouraged to hold shares in the Company. The Remuneration Committee's guidelines require a holding equal to the value of a percentage of salary as set out below and excludes shares earned but not yet vested under Company share plans.

Shareholding guidelines	Multiple of base salary %
Chief Executive	200
Finance Director and Chief Information Officer	150
Chief Operating Officer	150
Management Board	100

Incentive review – revision of shareholding guidelines with effect from 1 April 2011:	Multiple of base salary %
Chief Executive	300
Finance Director and Chief Information Officer	200
Chief Operating Officer	200
Management Board	100

At the date of this report, Paul Adams (Chief Executive), Nicandro Durante (Chief Executive Designate) and Ben Stevens (Finance Director and Chief Information Officer) each meet the current shareholding guidelines. There are transitional provisions in place for those Executive Directors and Management Board members who do not meet the requirements of the shareholding guidelines upon appointment. In such cases, individuals may, generally, only sell a maximum of up to 50 per cent of any shares vesting (after tax) under Company share plans until the threshold under the shareholding guidelines has been met.

Remuneration report (continued)

The interests of the Directors of the Company in the ordinary shares of the Company are shown in Table 5.

Executive Directors' pension benefits

Purpose	– provision of competitive post-retirement benefits
Delivery	– British American Tobacco UK Pension Fund and Company supplementary pension arrangements – monthly pension payment
Policy	– pension accrues at one-fortieth of annual base salary – Fund normal pensionable age of 60 – maximum pension payable will not exceed two-thirds of base salary averaged over the preceding 12 months – UK Pension Fund retains a scheme-specific cap following the introduction of the new UK pension regime in 2006 – excess benefits continue to be accrued within an unfunded unapproved retirement benefit scheme

Executive Directors (with the exception of Nicandro Durante) are, like other UK employees, eligible for membership of the British American Tobacco UK Pension Fund (Pension Fund).

The Pension Fund, for members who joined before 1 April 2005, is a non-contributory defined benefit scheme. The early retirement rules in the Pension Fund permit a member to draw the accrued retirement pension within five years of Fund normal retirement age without actuarial reduction, subject to the employing company's agreement. Alternatively, an Executive Director may choose to leave and take a pension at any time on or after his or her 50th birthday without the employing company's agreement, subject to a reduction as determined by the Pension Fund trustee in conjunction with the Pension Fund actuary. Accrual rates differ according to individual circumstances but do not exceed one-fortieth of pensionable salary for each year of pensionable service.

Pensionable pay covers base salary only and therefore bonus awards and the value of benefits in kind are not pensionable.

The Pension Fund includes provision for spouses' benefits on death in service or after retirement. In the event of death in service, a spouse's pension equal to half of the member's prospective pension at normal retirement age would be payable. A spouse's pension payable in the event of death after retirement is equal to half of the member's full pension, irrespective of any decision to exchange part of the benefit for a lump sum.

Paul Adams, John Daly and Ben Stevens each joined the Pension Fund after 1989. As a result, prior to 6 April 2006, these individuals were subject to the HM Revenue & Customs cap on pensionable earnings (notionally £123,600 for the tax year 2010/11). In addition, each has an unfunded pension promise from the Company in respect of earnings above the cap on an equivalent basis to the benefits provided by the Pension Fund. This is provided through membership of an unfunded unapproved retirement benefit scheme (UURBS).

These unfunded commitments are included in note 12 to the accounts. Members of the Pension Fund are entitled to receive increases in their pensions once in payment in line with price inflation (as measured by the Retail Prices Index) up to 6 per cent per annum.

John Daly was formerly a member of the P J Carroll Directors' Plan in Ireland. He is also entitled to a deferred benefit currently amounting to €105,631 per annum, payable from the age of 60. This benefit is scheduled to increase each year between January 2011 and December 2015 by the lower of 4 per cent or the Irish Consumer Price Index. The increase amount is confirmed each year by the Minister of Social Protection in Ireland (the increase for 2010 was 0 per cent).

Nicandro Durante is a member of the Fundacao Albino Souza Cruz (FASC) in Brazil. This is a non-contributory defined benefit scheme and includes a spouse's death in service benefit equal to 37.5 per cent of the member's prospective pension at normal retirement age. Accrual rates do not exceed 1.85 per cent of basic salary (excluding bonus) averaged over the 12 months to normal retirement age, for each year of pensionable service. Nicandro Durante's Brazilian pensionable salary will be reviewed by the Company annually with reference to the salary of that of a General Manager of Souza Cruz SA which will be adjusted annually in line with local practice and agreed with the Company. Benefits from the FASC remain subject to the rules of that scheme.

In addition, Nicandro Durante accrues a pension of 0.65 per cent for each year of service (the UK Accrual Rate) with effect from 1 March 2006, being the date of his appointment as a member of the Management Board. At retirement the pension will be based on Nicandro Durante's 12 month average UK base salary (excluding bonus) immediately prior to retirement. This accrued pension will be provided through the UURBS. Further, the UK Accrual Rate for the element of the base salary in excess of £670,000 increases from 0.65 per cent as stated above to 2.50 per cent for each year of service and will continue to be provided through the UURBS. The initial base salary level of £670,000 in respect of the 2.50 per cent accrual provided through the UURBS will be adjusted annually by the same percentage as that agreed for Nicandro's Durante's pensionable salary for the purposes of calculating benefits payable from the FASC.

Executive Directors' service contracts

Each Executive Director has a one year rolling contract, executed at the time of his original appointment. The contract may be varied from time to time to take account of changes in terms and conditions as well as to incorporate best practice. Each contract includes a provision for a termination or compensation payment in lieu of notice.

The Remuneration Committee, however, maintains the discretion to vary the policy of one year rolling contracts in the event that an Executive Director is recruited externally or from overseas, when it may then be appropriate to offer a contract with an initial period of longer than one year, reducing to a one year rolling contract after the expiry of the initial period.

An Executive Director's compensation payment, in lieu of notice, would comprise: (1) 12 months' salary at his then current base pay; and (2) a cash payment in respect of other benefits under the contract such as medical insurance, or the Company may at its option continue those benefits for a 12 month period. The Committee maintains discretion as to how to deal with any grants or awards made prior to termination under the LTIPs, the IEIS and the Share Option Scheme (if appropriate). Pension entitlements are dealt with in accordance with the terms and conditions of the applicable pension scheme and do not form part of the contractual compensation payment.

The compensation payment is payable where the requisite 12 months' notice is not given to the Executive Director or when he terminates by giving 12 months' notice and the Company does not wish him to serve his notice. If a period of notice is served, the compensation payment is reduced pro rata. In the unlikely event that the contract is terminated for cause (such as gross misconduct), the Company may terminate the contract with immediate effect and no compensation would be payable.

Nicandro Durante has a service contract with the Company in the form outlined above. In addition, as a result of the application of local labour laws in Brazil, Nicandro Durante retains certain termination or compensation rights in respect of his former employment with Souza Cruz SA. In the event of any compensation being payable to Nicandro Durante pursuant to his service contract with the Company, these Souza Cruz rights will be taken into account first in arriving at a final compensation amount in order that he does not benefit twice from these dual arrangements.

Executive Directors' external appointments

Executive Directors and members of the Management Board are able to accept one substantive external Board appointment provided that permission is respectively sought from the Board or Chairman. Any fees from such appointments are retained by the individual in recognition of the increased level of personal commitment required. None of the Executive Directors or Management Board members currently holds such an appointment.

During the year, Nicandro Durante, an Executive Director of the Company, was a non-executive director of Reynolds American Inc (RAI) (an associate undertaking of the Company) having been designated by Brown & Williamson Holdings, Inc. (a wholly-owned indirect subsidiary of the Company), as its nominee to sit on the board of RAI. In accordance with present arrangements, the Group received a fee of US$195,525 from RAI (2009: US$215,020) in respect of Nicandro Durante's service in that role up to 1 December 2010, the date of his resignation from that position.

On 1 December 2010, John Daly, an Executive Director of the Company, became a non-executive director of RAI. Further to the present arrangements, the Group received a fee of US$17,775 from RAI in respect of John Daly's service in that role up to 31 December 2010.

Non-Executive Directors' terms of appointment

The Non-Executive Directors do not have service contracts with the Company but instead have letters of appointment. Since 2010, all Non-Executive Directors have terms of appointment of one year only which are considered for renewal around the time of the Company's Annual General Meeting each year.

The date of appointment, the most recent reappointment and length of service for each Non-Executive Director are shown in the table below.

Non-Executive Director	Date of appointment	Date of last reappointment at AGM	Length of service as at 2011 Annual General Meeting (Years/Months)
Karen de Segundo	1 October 2007	30 April 2008	3.7
Robert Lerwill	1 January 2005	30 April 2009	6.4
Ana Maria Llopis[1]	24 February 2003	28 April 2010	8.2
Christine Morin-Postel	1 October 2007	28 April 2010	3.7
Gerry Murphy	13 March 2009	30 April 2009	2.1
Kieran Poynter	1 July 2010	–	0.10
Anthony Ruys	1 March 2006	28 April 2010	5.2
Sir Nicholas Scheele	28 February 2005	30 April 2009	6.2

Note:
1. Ana Maria Llopis will retire as a Non-Executive Director at the conclusion of the 2011 Annual General Meeting.

Remuneration report (continued)

On termination, at any time, a Non-Executive Director is entitled to any accrued but unpaid Director's fees but not to any other compensation.

Non-Executive Directors' remuneration policy

The current fees structure for the Non-Executive Directors is shown below:

	With effect from 1 Jan 2011 £	Jan-Dec 2010 £
Basic fee	**90,000**	90,000
Supplements:		
– Senior Independent Director	**28,000**	25,000
– Audit Committee Chairman	**28,000**	25,000
– CSR Committee Chairman	**23,000**	20,000
– Nominations Committee Chairman	**–**	–
– Remuneration Committee Chairman	**23,000**	20,000
Committee Membership Fees (not Chairmen):		
– Audit Committee	**5,000**	–
– CSR Committee	**5,000**	–
– Nominations Committee	**–**	–
– Remuneration Committee	**–**	–

The fees for the Non-Executive Directors are considered annually and are determined in light of market best practice and with reference to the time commitment and responsibilities associated with the roles.

In October 2010, in order to recognise the growing workload of the Board Committees, two changes were made to the fees' structure for the Non-Executive Directors with effect from 1 January 2011: (1) a membership fee was introduced for those Non-Executive Directors sitting on the Audit Committee and the CSR Committee who are not the Chairman of either of those Committees (no membership fees are currently payable for membership of the Nominations Committee and the Remuneration Committee); and (2) an increase was agreed to each of the supplement fees. The basic fee remains unchanged.

Non-Executive Directors' fees (including those of the Chairman) are determined within the overall aggregate annual limit of £2,500,000 authorised by shareholders with reference to the Company's Articles of Association. The Board as a whole considers the policy and structure for the Non-Executive Directors' fees on the recommendation of the Chairman and the Chief Executive. The Non-Executive Directors do not participate in discussions on their specific levels of remuneration.

Non-Executive Directors receive no other pay or benefits (with the exception of reimbursement of expenses incurred in respect of their duties as Directors of the Company). It is the policy of the Board that the spouses of the Executive Directors and Non-Executive Directors may accompany the Directors for business purposes on designated trips and functions during the year.

Anthony Ruys has been a Non-Executive Director of ITC Limited (ITC) (an associate undertaking of the Company) since 20 January 2009. During the year ended 31 December 2010, Anthony Ruys received INR680,000 (£9,713) in fees from ITC (2009: INR196,712 (£2,475)). This amount is the subject of an annual supplement from a Group company so that he receives a total annual fee for this appointment of £75,000. Anthony Ruys also has an interest in options over shares in ITC – see Table 8.

Chairman's terms of appointment and remuneration

The Remuneration Committee is responsible for determining the terms of engagement and fees payable to the Chairman. This process takes into account the breadth of that role coupled with its associated levels of commitment and expertise.

Richard Burrows has been a Director of the Company since 1 September 2009 and has been Chairman of the Company from 1 November 2009. The terms of his appointment provide that he holds the appointment for an initial term of two years unless terminated earlier by: (1) the Company giving three months' notice or a discretionary compensation payment in lieu of notice; or (2) by him giving one month's written notice; with the Company having discretion to make a compensation payment in lieu of such notice. The compensation payment is limited to any fees which are payable for such part of the relevant notice period as the Board does not require him as Chairman to perform his duties.

The current terms of Richard Burrows' appointment provide for: (1) an annual fee of £525,000; (2) the use of a driver; (3) private medical insurance and personal accident insurance benefits; and (4) the reimbursement by the Company of the cost of return airline tickets to London from Ireland in connection with his duties as Chairman. In common with the Non-Executive Directors, Richard Burrows does not participate in the British American Tobacco share schemes, bonus schemes or incentive plans and is not a member of any Group pension plan.

In February 2011, the Remuneration Committee reviewed the fees for the Chairman against practice in the FTSE 30 and agreed to increase his annual fees from £525,000 to £570,000 with effect from 1 April 2011.

Copies of service contracts and terms of appointment

Copies of the Executive Directors' service contracts and the details of the terms of appointment of each Non-Executive Director and the Chairman are available for inspection during normal business hours at the Company's registered office and will also be available for inspection at the Annual General Meeting on 28 April 2011.

Appendices to the Remuneration report

Table 1: Aggregate emoluments – audited

The emoluments of the Directors of British American Tobacco p.l.c. were as follows:

	2010 £	2009 £
Salaries and fees	4,094,584	3,807,417
Benefits: cash and non-cash	1,214,506	779,927
Performance-related pay		
– cash bonus	3,500,527	1,572,915
– deferred share bonus	1,257,217	1,572,915
– DSBS and LTIP equivalents	701,947	459,222
– Share Reward Scheme	6,084	8,100
Former Directors	43,602	747,543
Total	10,818,467	8,948,039

Table 2: Individual fees of the Chairman and Non-Executive Directors – audited

	Fees £	Benefits £	Total 2010 £	Total 2009 £
Richard Burrows (from 1 September 2009)	525,000	157,319	682,319	178,317
Karen de Segundo	110,000	16,399	126,399	118,082
Robert Lerwill	115,000	774	115,774	116,331
Ana Maria Llopis	90,000	–	90,000	90,000
Christine Morin-Postel	90,000	–	90,000	90,000
Gerry Murphy (from 13 March 2009)	90,000	8,103	98,103	72,958
Kieran Poynter (from 1 July 2010)	45,000	118	45,118	–
Anthony Ruys	110,000	5,543	115,543	110,000
Sir Nicholas Scheele	115,000	16,131	131,131	115,811
Former Chairman				
Jan du Plessis (until 31 October 2009)	–	–	–	584,919
Former Non-Executive Director				
Thys Visser (until 30 April 2009)	–	–	–	30,000
Total	1,290,000	204,387	1,494,387	1,506,418

Notes:
1. Richard Burrows' benefits as Chairman comprise: (1) the use of a company driver; (2) installation and maintenance of home security systems (£44,378); and (3) travel and other expenses incurred in connection with accompanied attendance at business functions and/or corporate events.
2. Benefits for Non-Executive Directors comprise those expenses incurred in connection with accompanied attendance at business functions.
3. In addition, Anthony Ruys received INR680,000 (£9,713) (2009: INR196,712 (£2,475)) from ITC Limited, the Group's associate undertaking in India, in respect of his services as a Non-Executive Director of that company during 2010 (appointed 20 January 2009). This was supplemented by a further payment of £65,287 (2009: £68,621) paid by the Group for services up to and including 31 December 2010, so that he receives a total annual fee for this appointment of £75,000.

Remuneration report (continued)

Table 3: Summary individual emoluments of Executive Directors – audited

	Salary £	Benefits £	Performance related pay £	Total 2010 £	2009 £
Paul Adams	1,273,750	149,560	2,711,902	4,135,212	3,316,748
Nicandro Durante	660,000	586,929	1,161,457	2,408,386	1,922,198
Ben Stevens	654,167	108,655	1,248,414	2,011,236	1,485,132
John Daly (from 1 September 2010)	216,667	164,975	344,002	725,644	–
Total	2,804,584	1,010,119	5,465,775	9,280,478	6,724,078

Former Executive Directors

	Salary £	Benefits £	Performance related pay £	Total 2010 £	2009 £
Antonio Monteiro de Castro (until 31 December 2007)	–	8,401	–	8,401	709,421
Paul Rayner (until 30 April 2008)	–	35,201	–	35,201	8,122
Total	–	43,602	–	43,602	717,543

Notes:
1. The benefits shown for Antonio Monteiro de Castro and Paul Rayner comprise principally their contractual entitlements to tax advice in respect of their relocations back to Brazil and Australia respectively.
2. The Executive Directors' remuneration shown above does not include, in respect of the LTIP awards made in May 2008 and which will vest on 15 May 2011: (1) the illustrative values of those awards as at 22 February 2011 (reference should be made to the illustrative values shown for each Executive Director in Table 6); and (2) the values of the LTIP dividend equivalent payments to be made in respect of those awards which are: Paul Adams £353,636; Nicandro Durante £222,936; Ben Stevens £157,913; and John Daly £111,468.

Table 4: Analysis of remuneration of Executive Directors – audited

Paul Adams

	2010 £		2009 £
Salary	1,273,750	Salary	1,213,750
Benefits: cash	15,840	Benefits: cash	16,780
Benefits: non-cash	133,720	Benefits: non-cash	129,981
Annual cash bonus	2,243,310	Annual cash bonus	829,325
Value of deferred share bonus	–	Value of deferred share bonus	829,325
Cash dividend equivalent (DSBS)	69,178	Cash dividend equivalent (DSBS)	61,318
Cash dividend equivalent (LTIP)	397,386	Cash dividend equivalent (LTIP)	233,569
Share Reward Scheme: value of shares received during the year	2,028	Share Reward Scheme: value of shares received during the year	2,700
Total – see Table 3	4,135,212	**Total – see Table 3**	3,316,748

Notes:
1. Cash benefits comprise: a car allowance (£15,840).
2. Non-cash benefits comprise: (1) life and health insurance (£45,090); (2) the use of a company driver; (3) maintenance of home security systems (£3,265); and (4) other expenses incurred in connection with accompanied attendance at business functions and/or corporate events.
3. Paul Adams will retire as Chief Executive on 28 February 2011 and will cease to be an employee of the Company from that date. In accordance with the rules of the IEIS, his performance-related bonus in respect of the year ended 31 December 2010 is therefore payable as a 100 per cent cash bonus instead of 50 per cent in cash and 50 per cent in deferred shares.
4. Cash dividend equivalent payments: (1) DSBS – these are cash sums equivalent to the dividend on the after-tax position on all unvested ordinary shares comprised in the share awards held by participants in the DSBS at each dividend record date; and (2) LTIP – this is a cash sum equivalent to the dividends that an LTIP participant would have received as a shareholder on the actual number of shares under an LTIP award.

Table 4: Analysis of remuneration of Executive Directors – audited continued

Nicandro Durante

	2010 £		2009 £
Salary	660,000	Salary	622,500
Benefits: cash	13,560	Benefits: cash	43,157
Benefits: non-cash	573,369	Benefits: non-cash	407,601
Annual cash bonus	524,275	Annual cash bonus	383,985
Value of deferred share bonus	524,275	Value of deferred share bonus	383,985
Cash dividend equivalent (DSBS)	25,046	Cash dividend equivalent (DSBS)	13,690
Cash dividend equivalent (LTIP)	85,833	Cash dividend equivalent (LTIP)	64,580
Share Reward Scheme: value of shares received during the year	2,028	Share Reward Scheme: value of shares received during the year	2,700
Total – see Table 3	**2,408,386**	**Total – see Table 3**	1,922,198

Notes:
1. Cash benefits comprise: a car allowance (£13,560).
2. Non-cash benefits comprise: (1) life and health insurance (£10,698); (2) tax advice (£54,720); (3) the use of a company driver; (4) travel and related costs in respect of the relocation of Nicandro Durante from Brazil (£136,719); (5) employee welfare and medical payments made by Souza Cruz SA in respect of Nicandro Durante's subsisting employment rights in Brazil (£88,428); (6) the payment by the Company of Nicandro Durante's income tax liability on a cash-based equivalent LTIP award made to him in 2005 (when he was located in Brazil) and which vested in March 2008 (when he was located in the UK); the payment being made in accordance with the Company's policy whereby individuals are protected from paying no more than 100 per cent of their home tax rate (£165,233); (7) installation and maintenance of home security systems in the UK and Brazil (£35,918); and (8) other expenses incurred in connection with accompanied attendance at business functions and/or corporate events.
3. Cash dividend equivalent payments: (1) DSBS – these are cash sums equivalent to the dividend on the after-tax position on all unvested ordinary shares comprised in the share awards held by participants in the DSBS at each dividend record date; and (2) LTIP – this is a cash sum equivalent to the dividends that an LTIP participant would have received as a shareholder on the actual number of shares under an LTIP award.

Ben Stevens

	2010 £		2009 £
Salary	654,167	Salary	582,500
Benefits: cash	13,560	Benefits: cash	14,500
Benefits: non-cash	95,095	Benefits: non-cash	80,157
Annual cash bonus	563,400	Annual cash bonus	359,605
Value of deferred share bonus	563,400	Value of deferred share bonus	359,605
Cash dividend equivalent (DSBS)	24,215	Cash dividend equivalent (DSBS)	17,896
Cash dividend equivalent (LTIP)	95,371	Cash dividend equivalent (LTIP)	68,169
Share Reward Scheme: value of shares received during the year	2,028	Share Reward Scheme: value of shares received during the year	2,700
Total – see Table 3	**2,011,236**	**Total – see Table 3**	1,485,132

Notes:
1. Cash benefits comprise: a car allowance (£13,560).
2. Non-cash benefits comprise: (1) life and health insurance (£5,741); (2) the use of a company driver; (3) installation and maintenance of home security systems (£5,563); and (4) other expenses incurred in connection with accompanied attendance at business functions and/or corporate events.
3. Cash dividend equivalent payments: (1) DSBS – these are cash sums equivalent to the dividend on the after-tax position on all unvested ordinary shares comprised in the share awards held by participants in the DSBS at each dividend record date; and (2) LTIP – this is a cash sum equivalent to the dividends that an LTIP participant would have received as a shareholder on the actual number of shares under an LTIP award.

Remuneration report (continued)

Table 4: Analysis of remuneration of Executive Directors – audited continued

John Daly
(from 1 September 2010)

	2010 £		2009 £
Salary	216,667	Salary	–
Benefits: cash	110,382	Benefits: cash	–
Benefits: non-cash	54,593	Benefits: non-cash	–
Annual cash bonus	169,542	Annual cash bonus	–
Value of deferred share bonus	169,542	Value of deferred share bonus	–
Cash dividend equivalent (DSBS)	4,918	Cash dividend equivalent (DSBS)	–
Cash dividend equivalent (LTIP)	–	Cash dividend equivalent (LTIP)	–
Share Reward Scheme: value of shares received during the year	–	Share Reward Scheme: value of shares received during the year	–
Total – see Table 3	**725,644**	**Total – see Table 3**	–

Notes:
1. The amounts shown for John Daly are apportioned to reflect those sums received since the date of his appointment as a Director from 1 September 2010.
2. Cash benefits comprise: (1) a car allowance (£4,520); and (2) a contractual payment made in respect of the relocation of John Daly from Hong Kong (£105,862).
3. Non-cash benefits comprise: (1) health insurance (£914); (2) tax advice in respect of the relocation of John Daly from Hong Kong (£4,898); (3) the use of a company driver; (4) installation and maintenance of home security systems (£2,800); and (5) other expenses incurred in connection with accompanied attendance at business functions and/or corporate events.
4. Cash dividend equivalent payments: (1) DSBS – these are cash sums equivalent to the dividend on the after-tax position on all unvested ordinary shares comprised in the share awards held by participants in the DSBS at each dividend record date; and (2) LTIP – this is a cash sum equivalent to the dividends that an LTIP participant would have received as a shareholder on the actual number of shares under an LTIP award.

Table 5: Directors' interests in British American Tobacco p.l.c. ordinary shares of 25p

	At 1 Jan 2010 or date of appointment	At 31 Dec 2010	Changes from 31 Dec 2010	At 22 Feb 2011
Richard Burrows	10,000	10,000	–	**10,000**
Paul Adams	164,617	162,115	10	**162,125**
Nicandro Durante	106,778	112,167	11	**112,178**
Ben Stevens	49,983	77,902	–	**77,902**
John Daly (from 1 September 2010)	1,593	22,795	–	**22,795**
Karen de Segundo	4,050	2,000	–	**2,000**
Robert Lerwill	3,000	3,000	–	**3,000**
Ana Maria Llopis	2,200	2,200	–	**2,200**
Christine Morin-Postel	4,700	4,700	–	**4,700**
Gerry Murphy	3,000	3,000	–	**3,000**
Kieran Poynter (from 1 July 2010)	5,000	5,000	–	**5,000**
Anthony Ruys	3,000	3,000	–	**3,000**
Sir Nicholas Scheele	5,000	5,000	–	**5,000**
Total	362,921	412,879	21	**412,900**

Notes:
1. The changes in Directors' interests since 31 December 2010 relate to the purchase of shares pursuant to the Company's Partnership Share Scheme.
2. Based on the performance for 2010, the Executive Directors will each be awarded a number of ordinary shares to the value of £2,610 pursuant to an appropriation of shares under the Share Reward Scheme on 1 April 2011.
3. In addition to the shares shown above, the Executive Directors have further interests in the ordinary shares in the Company set out in Table 6 below and which are held in trust pursuant to the British American Tobacco DSBS. The value of these shares has been included as Directors' emoluments in the prior year. Details of the DSBS are given in the Remuneration report.
4. On 31 December 2010, the Group's employee share ownership trust referred to in the Remuneration report held a total of 11,949,088 ordinary shares in the Company. All participating employees, including the Executive Directors, are deemed to have a beneficial interest in these shares.

Remuneration report (continued)

Table 6: Executive Directors' (1) Long-Term Incentive Plan 2007 awards; (2) Deferred Share Bonus Scheme share interests; and (3) share options – ordinary shares of 25p in British American Tobacco p.l.c. – audited

Paul Adams

Shares
Long-Term Incentive Plan

	Performance period	Award date	At 1 Jan 2010 Number of shares	Awarded in 2010 Number of shares	Vested in 2010 Number of shares	Lapsed in 2010 Number of shares	At 31 Dec 2010 Number of shares	Value vested in 2010 £	Vesting date	Illustrative value vesting 2011 £
	2007/2009	15-May-07	159,337	–	159,337	–	–	3,530,908	15-May-10[1]	–
	2008/2010	15-May-08	163,418	–	–	–	163,418	–	15-May-11[3]	3,986,582[3]
	2009/2011	27-Mar-09	224,192	–	–	–	224,192	–	27-Mar-12[3]	–
	2010/2012	25-Mar-10	–	162,754	–	–	162,754	–	25-Mar-13[3]	–
Total			546,947	162,754	159,337		550,364	3,530,908		3,986,582

Deferred Share Bonus Scheme

	Award date	At 1 Jan 2010 Number of shares	Awarded in 2010 Number of shares	Released in 2010 Number of shares	At 31 Dec 2010 Number of shares
	13-Mar-07	46,083	–	46,083	–
	13-Mar-08	25,603	–	–	25,603
	27-Mar-09	63,297	–	–	63,297
	25-Mar-10	–	36,728	–	36,728
Total		134,983	36,728	46,083	125,628

Options – Sharesave Scheme

At 1 Jan 2010 Number of shares	Grant date	Grant price	Granted in 2010 Number of shares	Exercised on 9 Mar 2010[1] Number of shares	Market price	Gain £	At 31 Dec 2010 Number of shares	Dates from which exercisable	Latest expiry date
2,492	25-Nov-04	663.0p	–	2,492	2,306.5p	40,956	–	Jan 2010	Jun 2010

Long-Term Incentive Plan Notes:

1. LTIP award 15 May 2007: in order to enable participants to elect to be taxed on this award in the 2009/10 tax year, certain Executive Directors entered into restricted share agreements in March 2010 whereby each participant elected to receive the beneficial interest in the shares underlying the 2007 award to the extent that the performance conditions had been met. Each participant paid their respective tax liabilities to the Company from their own funds based on the closing mid-market price on 15 March 2010 (2,216.0p). The shares were held by the trustee of the British American Tobacco Group Employee Trust until the vesting date of 15 May 2010 at which point the restricted shares were eligible to be transferred to the participants. The vesting of the awards on 15 May 2010 was reported in the Company's Annual Report 2009 showing illustrative vesting values based on the mid-market price of ordinary shares of 2,200.0p at 22 February 2010, being the latest practicable date prior to publication of that report. The closing mid-market price on 17 May 2010 (being the next business day following the vesting date of 15 May 2010) was 2,040.5p.
2. The closing mid-market price of ordinary shares in British American Tobacco p.l.c. on the following award dates was: 15 May 2007 (1,590.0p); 15 May 2008 (1,966.0p); 27 March 2009 (1,534.0p); and 25 March 2010 (2,278.0p).
3. Paul Adams will retire as Chief Executive on 28 February 2011 and the Remuneration Committee has determined that all of his outstanding LTIP awards will vest and be exercisable from 1 March 2011. The May 2008 award will vest at 100 per cent in the manner described in the Remuneration report. For illustrative purposes only, the share price on 22 February 2011, being the latest practicable date prior to publication, of 2,439.5p has been used to value the vesting of that award. Paul Adams' March 2009 award and the March 2010 award will be subject to pro-rata (time and performance) vesting criteria; at 31 December 2010 the performance percentage reflecting performance to date was 86.5 per cent for the March 2009 award and 81.4 per cent for the March 2010 award.
4. The performance conditions applicable to the LTIP awards relate to an apportionment between measures relating to TSR- and EPS-based criteria with reference to a three year performance period. TSR combines both the share price and dividend performance of the Company as set against two comparator groups: (a) the FTSE 100 Index at the beginning of the performance period; and (b) a peer group of FMCG companies. A total of 50 per cent of the total award is based upon each of two separate measures (25 per cent for each measure). Fifty per cent of an award is based on EPS growth relative to inflation. Further details of the performance conditions are set out in the Long-Term incentives section of the Remuneration report.
5. There have been no variations in the terms and conditions of the LTIP interests during the year.

Deferred Share Bonus Scheme Notes:
1. Each Executive Director has an interest in the ordinary shares of the Company, as shown in the DSBS tables, which are held in trust pursuant to the British American Tobacco DSBS.
2. The cost of these shares has been included as Directors' emoluments in the prior year. Details of the Deferred Share Bonus Scheme are given in the Remuneration report.
3. The DSBS shares awarded on 13 March 2007 were released on 15 March 2010. The closing mid-market price of ordinary shares in British American Tobacco p.l.c. on 15 March 2010 was 2,216.0p.

Sharesave Scheme Notes:
1. Sharesave Scheme: in respect of the Executive Directors, no options lapsed during the year ended 31 December 2010. There have been no variations in the terms and conditions of these interests in share options during the year. Options granted under the Sharesave Scheme are exercisable in conjunction with a three-year or five-year savings contract up to a monthly limit of £250. Options are normally granted at a discount of 20 per cent to the market price at the time of the invitation, as permitted under the rules of the Sharesave Scheme.
2. The aggregate gain on the exercise of Sharesave Scheme options by the relevant Executive Directors (Paul Adams and Ben Stevens) was £81,912 (2009: £nil).
3. The closing mid-market price of ordinary shares in British American Tobacco p.l.c. on 31 December 2010 was 2,463.5p and the range during the year was 1,959.0p to 2,521.0p. The market price on 31 December 2010 exceeded the grant price of all the options detailed in the Options tables for the Executive Directors.

Nicandro Durante

Shares

Long-Term Incentive Plan

	Performance period	Award date	At 1 Jan 2010 Number of shares	Awarded in 2010 Number of shares	Vested in 2010 Number of shares	Lapsed in 2010 Number of shares	At 31 Dec 2010 Number of shares	Value vested in 2010 £	Vesting date	Illustrative value vesting 2011 £
	2008/2010	15-May-08	74,962	–	–	–	74,962	–	15-May-11	1,828,697[4]
	2009/2011	27-Mar-09	94,996	–	–	–	94,996	–	27-Mar-12	–
	2010/2012	25-Mar-10	–	69,751	–	–	69,751	–	25-Mar-13	–
Total			169,958	69,751	–	–	239,709	–		1,828,697

Deferred Share Bonus Scheme

	Award date	At 1 Jan 2010 Number of shares	Awarded in 2010 Number of shares	Released in 2010 Number of shares	At 31 Dec 2010 Number of shares
	13-Mar-07	10,566	–	10,566	–
	13-Mar-08	6,028	–	–	6,028
	27-Mar-09	29,164	–	–	29,164
	25-Mar-10	–	17,005	–	17,005
Total		45,758	17,005	10,566	52,197

Options – Sharesave Scheme

At 1 Jan 2010 Number of shares	Grant date	Grant price	Granted in 2010 Number of shares	Exercised in 2010[1,2] Number of shares	At 31 Dec 2010 Number of shares	Dates from which exercisable	Latest expiry date
1,421	24-Nov-06	1,152.0p	–	–	1,421	Jan 2012	Jun 2012

Remuneration report (continued)

Table 6: Executive Directors' (1) Long-Term Incentive Plan awards; (2) Deferred Share Bonus Scheme share interests; and (3) share options – ordinary shares of 25p in British American Tobacco p.l.c. – audited continued

Long-Term Incentive Plan Notes:

1. On 2 March 2010, Nicandro Durante exercised a cash-based award equivalent in value to 31,380 shares. This award had been made in March 2006 and was subject to the same performance conditions and vesting terms as an equivalent award made under the 1998 LTIP. This award vested on 15 March 2009 and was exercisable from that date. The closing mid-market price of ordinary shares on 2 March 2010 was 2,289.0p, giving a value at the date of exercise of £718,288.
2. Cash-based phantom LTIP award 15 May 2007: Nicandro Durante received this award over the equivalent of 34,416 shares, subject to the same performance conditions and vesting terms as awards made under the 2007 LTIP. On 15 March 2010 the notional shares attached to this award were the subject of a conditional payment agreement between the Company, Nicandro Durante and the trustee of the British American Tobacco Group Employee Trust. This agreement was required in order to enable Nicandro Durante to pay the tax on the notional award of shares in the tax year 2009/10. Under this agreement, a cash amount was received by the trustee from the Company with reference to the value of the notional award of shares (to the extent that the performance conditions had been met) at the closing mid-market price of ordinary shares on 15 March 2010 (2,216.0p). The funds were held by the trustee until the vesting date of 15 May 2010 at which point an amount of £762,659 (referenced to the value of shares on 15 March 2010) was released to Nicandro Durante. No interest accrued on the funds between 15 March 2010 and the date of vesting.
3. The closing mid-market price of ordinary shares in British American Tobacco p.l.c. on the following award dates was: 15 May 2008 (1,966.0p); 27 March 2009 (1,534.0p); and 25 March 2010 (2,278.0p).
4. The May 2008 award will vest on 15 May 2011 at 100 per cent in the manner described in the Remuneration report. For illustrative purposes only, the share price on 22 February 2011, being the latest practicable date prior to publication, of 2,439.5p has been used to value the vesting awards.
5. The performance conditions applicable to the LTIP awards relate to an apportionment between measures relating to TSR and EPS-based criteria with reference to a three year performance period. TSR combines both the share price and dividend performance of the Company as set against two comparator groups: (a) the FTSE 100 Index at the beginning of the performance period; and (b) a peer group of FMCG companies. A total of 50 per cent of the total award is based upon each of two separate measures (25 per cent for each measure). Fifty per cent of an award is based on EPS growth relative to inflation. Further details of the performance conditions are set out in the Long-Term incentives section of the Remuneration report.
6. There have been no variations in the terms and conditions of the LTIP interests during the year.
7. The awards made in March 2009 and March 2010 are due to vest in March 2012 and March 2013 respectively. At 31 December 2010, the performance percentage reflecting performance to date, was 86.5 per cent for the March 2009 award and 81.4 per cent for the March 2010 award.

Deferred Share Bonus Scheme Notes:

1. Each Executive Director has an interest in the ordinary shares of the Company, as shown in the Deferred Share Bonus Scheme tables, which are held in trust pursuant to the British American Tobacco Deferred Share Bonus Scheme.
2. The cost of these shares has been included as Directors' emoluments in the prior year. Details of the Deferred Share Bonus Scheme are given in the Remuneration report.
3. The DSBS shares awarded on 13 March 2007 were released on 15 March 2010. The closing mid-market price of ordinary shares in British American Tobacco p.l.c. on 15 March 2010 was 2,216.0p.

Sharesave Scheme Notes:

1. Sharesave Scheme: in respect of the Executive Directors, no options lapsed during the year ended 31 December 2010. There have been no variations in the terms and conditions of these interests in share options during the year. Options granted under the Sharesave Scheme are exercisable in conjunction with a three year or five year savings contract up to a monthly limit of £250. Options are normally granted at a discount of 20 per cent to the market price at the time of the invitation, as permitted under the rules of the Sharesave Scheme.
2. The aggregate gain on the exercise of Sharesave Scheme options by the relevant Executive Directors (Paul Adams and Ben Stevens) was £81,912 (2009: £nil).
3. The closing mid-market price of ordinary shares in British American Tobacco p.l.c. on 31 December 2010 was 2,463.5p and the range during the year was 1,959.0p to 2.521.0p. The market price on 31 December 2010 exceeded the grant price of all the options detailed in the Options tables for the Executive Directors.

Ben Stevens

Shares

Long-Term Incentive Plan

Performance period	Award date	At 1 Jan 2010 Number of shares	Awarded in 2010 Number of shares	Vested in 2010 Number of shares	Lapsed in 2010 Number of shares	At 31 Dec 2010 Number of shares	Value vested in 2010 £	Vesting date	Illustrative value vesting 2011 £
2007/2009	15-May-07	38,240	–	38,240	–	–	847,398	15-May-10[1]	–
2008/2010	15-May-08	53,098	–	–	–	53,098	–	15-May-11	1,295,325[3]
2009/2011	27-Mar-09	88,663	–	–	–	88,663	–	27-Mar-12	–
2010/2012	25-Mar-10	–	65,323	–	–	65,323	–	25-Mar-13	–
Total		180,001	65,323	38,240	–	207,084	847,398		1,295,325

Deferred Share Bonus Scheme

	Award date	At 1 Jan 2010 Number of shares	Awarded in 2010 Number of shares	Released in 2010 Number of shares	At 31 Dec 2010 Number of shares
	13-Mar-07	12,293	–	12,293	–
	13-Mar-08	6,655	–	–	6,655
	27-Mar-09	26,114	–	–	26,114
	25-Mar-10	–	15,925	–	15,925
Total		45,062	15,925	12,293	48,694

Options – Sharesave Scheme

	At 1 Jan 2010 Number of shares	Grant date	Grant price	Granted in 2010 Number of shares	Exercised on 9 Mar 2010[1] Number of shares	Market price	Gain £	At 31 Dec 2010 Number of shares	Dates from which exercisable	Latest expiry date
	2,492	25-Nov-04	663.0p	–	2,492	2,306.5p	40,956	–	Jan 2010	Jun 2010
	1,000	25-Nov-09	1,555.0p	–	–	–	–	1,000	Jan 2015	Jun 2015
Total	3,492			–	2,492		40,956	1,000		

Remuneration report (continued)

Table 6: Executive Directors' (1) Long-Term Incentive Plan 2007 awards; (2) Deferred Share Bonus Scheme share interests; and (3) share options – ordinary shares of 25p in British American Tobacco p.l.c. – audited continued

Long-Term Incentive Plan Notes:

1. LTIP award 15 May 2007: in order to enable participants to elect to be taxed on this award in the 2009/10 tax year, certain Executive Directors entered into restricted share agreements in March 2010 whereby each participant elected to receive the beneficial interest in the shares underlying the 2007 award, to the extent that the performance conditions had been met. Each participant paid their respective tax liabilities to the Company from their own funds based on the closing mid-market price on 15 March 2010 (2,216.0p). The shares were held by the trustee of the British American Tobacco Group Employee Trust until the vesting date of 15 May 2010 at which point the restricted shares were eligible to be transferred to the participants. The vesting of the awards on 15 May 2010 was reported in the Company's Annual Report 2009 showing illustrative vesting values based on the mid-market price of ordinary shares of 2,200.0p at 22 February 2010, being the latest practicable date prior to publication of that report. The closing mid-market price on 17 May 2010 (being the next business day following the vesting date of 15 May 2010) was 2,040.5p.
2. The closing mid-market price of ordinary shares in British American Tobacco p.l.c. on the following award dates was: 15 May 2007 (1,590.0p); 15 May 2008 (1,966.0p); 27 March 2009 (1,534.0p); and 25 March 2010 (2,278.0p).
3. The May 2008 award will vest on 15 May 2011 at 100 per cent in the manner described in the Remuneration report. For illustrative purposes only, the share price on 22 February 2011, being the latest practicable date prior to publication, of 2,439.5p has been used to value the vesting awards.
4. The performance conditions applicable to the LTIP awards relate to an apportionment between measures relating to TSR and EPS-based criteria with reference to a three year performance period. TSR combines both the share price and dividend performance of the Company as set against two comparator groups: (a) the FTSE 100 Index at the beginning of the performance period; and (b) a peer group of FMCG companies. A total of 50 per cent of the total award is based upon each of two separate measures (25 per cent for each measure). Fifty per cent of an award is based on EPS growth relative to inflation. Further details of the performance conditions are set out in the Long-Term incentives section of the Remuneration report.
5. There have been no variations in the terms and conditions of the LTIP interests during the year.
6. The awards made in March 2009 and March 2010 are due to vest in March 2012 and March 2013 respectively. At 31 December 2010, the performance percentage reflecting performance to date, was 86.5 per cent for the March 2009 award and 81.4 per cent for the March 2010 award.

Deferred Share Bonus Scheme Notes:

1. Each Executive Director has an interest in the ordinary shares of the Company, as shown in the Deferred Share Bonus Scheme tables, which are held in trust pursuant to the British American Tobacco Deferred Share Bonus Scheme.
2. The cost of these shares has been included as Directors' emoluments in the prior year. Details of the Deferred Share Bonus Scheme are given in the Remuneration report.
3. The DSBS shares awarded on 13 March 2007 were released on 15 March 2010. The closing mid-market price of ordinary shares in British American Tobacco p.l.c. on 15 March 2010 was 2,216.0p.

Sharesave Scheme Notes:

1. Sharesave Scheme: in respect of the Executive Directors, no options lapsed during the year ended 31 December 2010. There have been no variations in the terms and conditions of these interests in share options during the year. Options granted under the Sharesave Scheme are exercisable in conjunction with a three year or five year savings contract up to a monthly limit of £250. Options are normally granted at a discount of 20 per cent to the market price at the time of the invitation, as permitted under the rules of the Sharesave Scheme.
2. The aggregate gain on the exercise of Sharesave Scheme options by the relevant Executive Directors (Paul Adams and Ben Stevens) was £81,912 (2009: £nil).
3. The closing mid-market price of ordinary shares in British American Tobacco p.l.c. on 31 December 2010 was 2,463.5p and the range during the year was 1,959.0p to 2,521.0p. The market price on 31 December 2010 exceeded the grant price of all the options detailed in the Options tables for the Executive Directors.

John Daly
(from 1 September 2010)

Shares
Long-Term Incentive Plan

Performance period	Award date	At 1 Sep 2010 Number of shares	Awarded in 2010 (post 1 Sep 2010) Number of shares	Vested in 2010 (post 1 Sep 2010) Number of shares	Lapsed in 2010 (post 1 Sep 2010) Number of shares	At 31 Dec 2010 Number of shares	Value vested in 2010 (post 1 Sep 2010) £	Vesting date	Illustrative value vesting 2011 £
2008/2010	15-May-08	37,481	–	–	–	37,481	–	15-May-11	914,349[2]
2009/2011	27-Mar-09	51,931	–	–	–	51,931	–	27-Mar-12	–
2010/2012	25-Mar-10	37,643	–	–	–	37,643	–	25-Mar-13	–
Total		127,055	–	–	–	127,055	–		914,349

Deferred Share Bonus Scheme

	Award date	At 1 Sep 2010 Number of shares	Awarded in 2010 (post 1 Sep 2010) Number of shares	Released in 2010 (post 1 Sep 2010) Number of shares	At 31 Dec 2010 Number of shares
	13-Mar-08	5,872	–	–	5,872
	27-Mar-09	15,151	–	–	15,151
	25-Mar-10	8,601	–	–	8,601
Total		29,624	–	–	29,624

Long-Term Incentive Plan Notes:
1. The closing mid-market price of ordinary shares in British American Tobacco p.l.c. on the following award dates was: 15 May 2008 (1,966.0p); 27 March 2009 (1,534.0p); and 25 March 2010 (2,278.0p).
2. The May 2008 award will vest on 15 May 2011 at 100 per cent in the manner described in the Remuneration report. For illustrative purposes only, the share price on 22 February 2011, being the latest practicable date prior to publication, of 2,439.5p has been used to value the vesting awards.
3. The performance conditions applicable to the LTIP awards relate to an apportionment between measures relating to TSR and EPS-based criteria with reference to a three year performance period. TSR combines both the share price and dividend performance of the Company as set against two comparator groups: (a) the FTSE 100 Index at the beginning of the performance period; and (b) a peer group of FMCG companies. A total of 50 per cent of the total award is based upon each of two separate measures (25 per cent for each measure). Fifty per cent of an award is based on EPS growth relative to inflation. Further details of the performance conditions are set out in the Long-Term incentives section of the Remuneration report.
4. There have been no variations in the terms and conditions of the LTIP interests during the year.
5. The awards made in March 2009 and March 2010 are due to vest in March 2012 and March 2013 respectively. At 31 December 2010 the performance percentage reflecting performance to date was 86.5 per cent for the March 2009 award and 81.4 per cent for the March 2010 award.

Deferred Share Bonus Scheme Notes:
1. Each Executive Director has an interest in the ordinary shares of the Company, as shown in the Deferred Share Bonus Scheme tables, which are held in trust pursuant to the British American Tobacco Deferred Share Bonus Scheme.
2. The cost of these shares has been included as Directors' emoluments in the prior year. Details of the Deferred Share Bonus Scheme are given in the Remuneration report.

Sharesave Scheme Notes:
1. John Daly was not a participant in the Sharesave Scheme as at the date of his appointment as an Executive Director (1 September 2010) or at 31 December 2010.

Remuneration report (continued)

Table 7: Executive Directors' pension entitlements – audited

	Fund normal retirement age	Total accrued pension at 31 Dec 2010 £	Gross increase in accrued pension £	Increase in accrued pension net of inflation £	Transfer value of net increase in accrual over period £	Transfer value of accrued pension at 31 Dec 2009 £	Transfer value of accrued pension at 31 Dec 2010 £	Total change in transfer value during period £
Paul Adams	60	626,540	56,469	32,416	764,016	12,936,971	14,767,041	1,830,070
Nicandro Durante[3]	60	464,917	80,468	62,168	1,315,028	7,971,698	9,840,627	1,868,929
Ben Stevens	60	189,495	32,031	24,519	483,547	3,082,063	3,737,054	654,991
John Daly[4]	60	171,133	21,114	13,957	300,151	3,162,365	3,680,288	517,923

Notes:

1. The amount of total accrued pension is the pension that would be paid annually on retirement based on service to the end of the year, excluding any increase granted under statute before retirement.
2. The value of net increase in accrued pension represents the incremental value to the Executive Director of his service during the year, calculated on the assumption that service terminated at the year end.
3. Nicandro Durante is entitled to a benefit promise of 0.65 per cent of final sterling pensionable salary (calculated as a 12 month average) in relation to service (the UK Accrual Rate) from 1 March 2006. This is provided through the unfunded unapproved retirement benefit scheme (UURBS). The UK Accrual Rate will increase from 0.65 per cent as stated above to 2.50 per cent in respect of the element of the base salary in excess of £670,000 for each year of service and will continue to be provided through the UURBS. In addition, Nicandro Durante is entitled to a pension from the Souza Cruz Pension Scheme based on an accrual rate of 1.85 per cent of final Brazilian real pensionable salary (calculated as a 12 month average) in relation to service from December 1981 (the value of this pension – in terms of sterling – has increased during 2010 due to a 9 per cent strengthening of the Brazilian real). The accrued pension amount and transfer value shown above are based on the sum of these promises (i.e. with the accrual rate since March 2006 being a total of 2.50 per cent). Nicandro Durante is entitled to receive that part of the promise from the Souza Cruz Pension Scheme (based on 1.85 per cent accrual rate) with immediate effect; this entitlement has been ignored for the purposes of the above transfer value.
4. John Daly was formerly a member of the P J Carroll Directors' Plan in Ireland. He is entitled to a deferred benefit currently amounting to €105,631 per annum payable from the age of 60. This deferred benefit is scheduled to increase each year between January 2011 and December 2015 by the lower of 4 per cent or the Irish Consumer Prices Index. The increase amount is confirmed each year by the Minister of Social Protection (the increase for 2010 is 0 per cent). The transfer value in respect of John Daly's deferred benefit is included in Table 7 above and has been calculated in accordance with the method used for the Pension Fund.
5. Changes in the transfer values reflect both individual Executive Director's circumstances such as the date of joining the Pension Fund and changes in salary during the year together with the application of market value adjustments in accordance with actuarial and legislative requirements. The transfer value basis used is consistent with that used by the Trustee of the Pension Fund for the ongoing funding of the Pension Fund. The transfer values of the accrued entitlement represent the value of assets that the Pension Fund would need to transfer to another pension provider on transferring the Pension Fund's liability in respect of Executive Directors' pension benefits. They do not represent sums payable to individual Executive Directors and, therefore, cannot be added meaningfully to annual remuneration. Further, although Nicandro Durante is not a member of the Pension Fund, the transfer values calculated above have been calculated in accordance with the method used for the Pension Fund. Although Paul Adams, Ben Stevens and John Daly receive a significant element of their overall entitlement from the UURBS, the transfer values above have been calculated in accordance with the method used for the Pension Fund.
6. The transfer value calculations at 31 December 2010 incorporate a change to the underlying transfer value basis from that used at 31 December 2009. This reflects a change in the statutory rate of increases applied between an individual's date of leaving the Fund to their retirement date from being in line with the Retail Prices Index, to increases in line with the Consumer Prices Index.
7. The Pension Fund is non-contributory. Voluntary contributions paid by Executive Directors and resulting benefits are not shown. No excess retirement benefits have been paid to or are receivable by any Executive Director or past Executive Director.

Table 8: Non-Executive Director's share options Ordinary Shares of INR1 each in ITC Limited – audited

Anthony Ruys
ITC Employee Stock Option Scheme

	At 1 Jan 2010 Number of options[2]	At 1 Jan 2010 Number of shares over which options held[2]	Grant date	Grant price per option	Granted in 2010 Number of options	Number of shares over which options granted	At 31 Dec 2010 Number of options	At 31 Dec 2010 Number of shares over which options held[2]	Number of options that may be exercised	Dates from which exercisable	Latest expiry date
	20,000	200,000	23-Jul-09	INR1090.00	–	–	20,000	200,000	6,000	23-Jul-10	23-Jul-15
									6,000	23-Jul-11	23-Jul-16
									8,000	23-Jul-12	23-Jul-17
	–	–	22-Jul-10	INR1461.75	20,000	200,000	20,000	200,000	6,000	22-Jul-11	22-Jul-16
									6,000	22-Jul-12	22-Jul-17
									8,000	22-Jul-13	22-Jul-18
Total	20,000	200,000			20,000	200,000	40,000	400,000	40,000		

Notes:
1. ITC Limited (ITC) is an associate undertaking of the Company and is listed on stock exchanges in India. Anthony Ruys, a Non-Executive Director of the Company, is also a Non-Executive Director of ITC. Anthony Ruys has been granted options over shares in ITC under the ITC Employee Stock Option Scheme 2006 which provides for the grant of options to its Non-Executive Directors as permitted by the Securities and Exchange Board of India (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines 1999 (the Scheme).
2. Each option entitles its holder to apply for and to be allotted 10 ordinary shares in ITC of INR1 each upon the payment of the grant price during the appropriate exercise period. An exercise period begins at the date of vesting of an option and expires at the end of five years from that vesting date. The vesting period for the conversion of an option under the Scheme is as follows: (a) 30 per cent vests 12 months from the date of grant; (b) 30 per cent vests 24 months from the date of grant; and (c) 40 per cent vests 36 months from the date of grant. No options were exercised by Anthony Ruys during the year ended 31 December 2010.

Status of Remuneration report

This report has been prepared in accordance with the relevant provisions of the Companies Act 2006 and Schedule 5 and Schedule 8 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008. The report also meets the relevant requirements of the Listing Rules of the UK Listing Authority and describes how the Board has applied the Principles of Good Governance relating to Directors' remuneration as set out in the UK Corporate Governance Code referred to in the Corporate governance statement. As required by the Companies Act 2006, a resolution to approve the Directors' Remuneration report (the Report) will be proposed at the Annual General Meeting of the Company on 28 April 2011, at which the financial statements will be presented for approval. The vote will have advisory status, will be in respect of the remuneration policy and overall remuneration packages and will not be specific to individual levels of remuneration. The Companies Act 2006 requires the auditors to report to the Company's shareholders on the 'audited information' within the Report and to state whether, in their opinion, those parts of the Report have been prepared in accordance with the Companies Act 2006. The report of the independent auditors, in respect of the Company, addresses those aspects of this Report and which have been subject to audit have been clearly marked: Table 1, Table 2, Table 3, Table 4, Table 6, Table 7 and Table 8.

On behalf of the Board

Anthony Ruys
Chairman of the Remuneration Committee

23 February 2011

Other statutory and regulatory information

Nicola Snook
Secretary

Companies Act 2006

The Companies Act 2006 requires the Company to set out in this report the development and performance of the business of the Group during the financial year ended 31 December 2010, including an analysis of the position of the Group at the end of the financial year, and a description of the principal risks and uncertainties facing the Group.

Principal activities

British American Tobacco p.l.c. is a holding company which owns, directly or indirectly, investments in the numerous companies constituting the British American Tobacco Group of companies. The principal subsidiaries and associates are listed on the Principal subsidiary and associate undertakings pages. All subsidiary undertakings are involved in activities directly or indirectly related to the manufacture, distribution or sale of tobacco products.

Group results and dividends

The Group results are addressed fully in the financial statements and in the Directors' report: Business review. The Board recommends to shareholders a final dividend of 81.0p per ordinary share of 25p for the year ended 31 December 2010. If approved by shareholders at the Annual General Meeting to be held on 28 April 2011, the dividend will be payable on 5 May 2011 to shareholders registered on either the UK main register or the South African branch register on 11 March 2011, the record date. The ex-dividend trading dates are 7 March 2011 on the JSE Limited (JSE) and 9 March 2011 on the London Stock Exchange (LSE). As the Group reports in sterling, dividends are declared and payable in sterling except for shareholders on the branch register in South Africa whose dividends are payable in rand.

A rate of exchange of £:R = 11.54580 as at 22 February 2011 (the closing rate for that date as quoted on Bloomberg), results in an equivalent final dividend of 935.20980 SA cents per ordinary share.

From the close of business on 4 March 2011 until the close of business on 11 March 2011, no transfers between the UK main register and the South African branch register are permitted and no shares may be dematerialised or rematerialised between 7 March 2011 and 11 March 2011, both days inclusive.

Further details of the total amounts of dividends paid in 2010 (with 2009 comparatives) are given in note 8 on the accounts.

Share capital

As at 31 December 2010, the Company had an allotted and fully paid share capital of 2,025,756,358 ordinary shares of 25p each with an aggregate nominal value of £506 million (including treasury shares and shares owned by the employee share trusts).

Purchase of own shares

During the year ended 31 December 2010, the Company made no purchases of its own shares. In February 2009, the Directors discontinued the share buy-back programme until further notice.

The Directors intend for the share buy-back programme to be reinstated following the Company's Preliminary Announcement on 24 February 2011. This on-market programme of buying back the Company's ordinary shares of 25p each will be conducted under the authority granted by shareholders at the 2010 Annual General Meeting. In the opinion of the Directors, the exercise of this authority is likely to result in an increase in the Company's earnings per share and will be in the interests of its shareholders generally.

At the 2010 Annual General Meeting, the Company was given authority to purchase up to 199,600,000 of its ordinary shares. The minimum price that may be paid for such shares is 25p and the maximum price is an amount equal to 105 per cent of the average of the middle market prices shown in the quotation for an ordinary share as derived from the London Stock Exchange Daily Official List for the five business days immediately preceding the day on which the ordinary share is contracted to be purchased. This present authority for the Company to purchase its own shares will expire at the 2011 Annual General Meeting.

In accordance with the Company's policy, any repurchased shares are held as treasury shares and as at 31 December 2010 the number of treasury shares was 28,960,054. While treasury shares are held no dividends are paid on them and they have no voting rights. Treasury shares may be resold at a later date.

In order that the Directors may further continue with the share buy-back programme, it is proposed that the authority for the Company to purchase its own shares is renewed with the applicable resolution to be put to shareholders at the 2011 Annual General Meeting. Details of the resolution and explanatory notes are contained in the Notice of Annual General Meeting which is sent to all shareholders and is also published on www.bat.com

Significant agreements – change of control

The following significant agreements contain certain termination and other rights for our counterparties upon a change of control of the Company.

On 7 August 2007, British American Tobacco Mexico, S.A. de C.V. (as borrower) and the Company, B.A.T. International Finance p.l.c. and B.A.T Capital Corporation (as guarantors) entered into a term credit facility arrangement with Barclays Capital (as mandated lead arranger), HSBC Bank plc (as agent) and certain financial institutions (as lenders) pursuant to which the lenders agreed to make available to the borrower US$690 million to refinance existing facilities and for general corporate purposes (the Facility). Pursuant to the Facility, should the borrower cease to be a direct or indirect subsidiary of the Company, the borrower shall immediately repay any outstanding amounts. Where there is a change of control in respect of the Company, the lenders can require all amounts outstanding under the Facility to be repaid.

On 10 July 2009, British American Tobacco Tütün Mamulleri Sanayi ve Ticaret Anonim Sirketi (as borrower), the Company and B.A.T. International Finance p.l.c. (as guarantors) entered into a term credit facility agreement with Barclays Bank PLC (as agent) and certain financial institutions (as lenders) pursuant to which the lenders agreed to make available to the borrower €700 million to refinance existing facilities and for general corporate purposes (the Facility). In December 2010, the borrower prepaid €250 million of the outstanding amount. Pursuant to the Facility, should the borrower cease to be a direct or indirect subsidiary of the Company, the borrower shall immediately repay any outstanding advances. Where there is a change of control in respect of the Company, the lenders can require all amounts outstanding under the Facility to be repaid.

On 25 November 2010, the Company, B.A.T. International Finance p.l.c. and British American Tobacco Holdings (The Netherlands) B.V. (as borrowers and, in the case of the Company, as a borrower and guarantor) entered into a revolving credit facility agreement with HSBC Bank plc (as agent) and certain financial institutions (as lenders) pursuant to which the lenders agreed to make available to the borrowers £2 billion for general corporate purposes (the Facility). Pursuant to the Facility, should a borrower (other than the Company) cease to be a direct or indirect subsidiary of the Company, such borrower shall immediately repay any outstanding advances made to it. Where there is a change of control in respect of the Company, the lenders can require all amounts outstanding under the Facility to be repaid.

Details of the change of control provisions contained in the Company's Long-Term Incentive Plans are given in the Remuneration report.

Contractual arrangements

Individual operating companies in the Group have contractual and other arrangements with many third parties in support of the Group's business activities including those covering input materials (filter tow, tobacco leaf and wrapping materials), logistics and distribution and information technology. Such contracts and arrangements may be deemed to be essential to one or more operating companies but there are no contracts or arrangements considered to be essential to the operation and understanding of the business or the Group as a whole.

Articles of Association

The following description summarises certain provisions of the Company's current Articles of Association (as adopted by special resolution at the Annual General Meeting on 28 April 2010), applicable English law and the Companies Act 2006 (the Companies Act). This summary is qualified in its entirety by reference to the Companies Act and the Company's Articles of Association, a copy of which is available on www.bat.com

Share capital

All of the Company's ordinary shares are fully paid and, accordingly, no further contribution of capital may be required by the Company from the holders of such shares.

Objects and purposes

The Company is incorporated under the name of British American Tobacco p.l.c. and is registered in England and Wales under registered number 3407696. Under the Companies Act 2006, the Company's objects are unrestricted.

Directors: appointment and retirement

The Company's Articles of Association provide for a Board of Directors, consisting (unless otherwise determined by ordinary resolution of the shareholders) of not fewer than five Directors, not subject to any maximum, who shall manage the business of the Company.

The Directors and the Company (by ordinary resolution) may appoint a person who is willing to act as a Director, either to fill a vacancy or as an additional Director. A Director appointed by the Directors shall retire at the next Annual General Meeting and will put himself/herself forward to be reappointed by the shareholders. Such a Director shall not be taken into account in determining the number or identity of the Directors to retire by rotation at that next Annual General Meeting.

At each Annual General Meeting, all Directors shall retire from office by rotation who: (1) held office at the time of each of the two preceding Annual General Meetings and who did not retire at either of them; and (2) if the number of Directors retiring in (1) above is less than one-third of the Directors who are subject to retirement by rotation (or, if their number is not three or a multiple of three, is less than the number which is nearest to but does not exceed one-third of the Directors), such additional number of Directors as shall, together with the Directors retiring under (1) above, equal one-third of the Directors (or, if their number is not three or a multiple of three, the number which is nearest to but does not exceed one-third of the Directors).

Subject to the provisions of the Companies Act and the Articles of Association, the Directors to retire at an Annual General Meeting under (2) above will be those who have been in office the longest since their appointment or last reappointment.

Notwithstanding these provisions contained in the Articles of Association, the Company is not restricted to the number of Directors who may retire and seek re-election each year. The Articles of Association merely set a minimum number of Directors who must be subject to retirement by rotation each year. As a result, since the new UK Corporate Governance Code provides that all Directors of FTSE 350 companies should be subject to annual re-election by shareholders, all of the Directors of the Company will be subject to either election (i.e. those Directors appointed by the Board of

Other statutory and regulatory information (continued)

Directors during the year) or re-election at the forthcoming Annual General Meeting to be held on 28 April 2011.

A Director who retires at an Annual General Meeting and is not reappointed shall retain office until the meeting elects someone in his place or, if it does not do so, until the conclusion of the meeting.

In addition to any power of removal under the Companies Act, the Company may, by special resolution, remove a Director before the expiration of his period of office and, subject to the Articles of Association, may by ordinary resolution, appoint another person who is willing to act as a Director, and is permitted by law to do so, to be a Director instead of him. A person so appointed shall be subject to retirement as if he had become a Director on the day on which the Director in whose place he is appointed was last appointed or reappointed a Director.

Fees for Non-Executive Directors and the Chairman shall be determined by the Directors but shall not exceed in aggregate an annual sum of £2,500,000, unless determined otherwise by ordinary resolution of the shareholders. The remuneration of the Executive Directors is determined by the Remuneration Committee which is comprised of independent Non-Executive Directors.

Directors: meetings and voting
The quorum for meetings of Directors is two Directors. The Directors may delegate any of their powers which are conferred upon them under the Articles of Association to such person or committee as they consider appropriate.

The Articles of Association place a general prohibition on a Director voting at a meeting of the Directors on any resolution concerning a matter in which he has an interest other than by virtue of his interest in shares in the Company. However, in the absence of some other interest not indicated below, a Director is entitled to vote and to be counted in a quorum for the purpose of any vote relating to a resolution concerning the following matters:

1. the giving to him of a guarantee, security or indemnity in respect of money lent to, or an obligation incurred by him for the benefit of, the Company or any of its subsidiaries;
2. the giving to a third party of a guarantee, security or indemnity in respect of an obligation of the Company or any of its subsidiaries for which the Director has assumed responsibility (in whole or part and whether alone or jointly with others) under a guarantee or indemnity or by the giving of security;
3. the giving to him of any other indemnity which is on substantially the same terms as indemnities given, or to be given, to all of the other Directors and/or to the funding by the Company of his expenditure on defending proceedings of the doing by the Company of anything to enable him to avoid incurring such expenditure where all other Directors have been given, or are to be given, substantially the same arrangements;
4. any proposal concerning the purchase of Directors' and officers' liability insurance;
5. any proposal concerning his being, or intending to become, a participant in the underwriting or sub-underwriting of an offer of any such shares, debentures or other securities for subscription, purchase or exchange;
6. any arrangements which relate in any way to a retirement benefits scheme or any arrangement for the benefit of the employees of the Company or any of its subsidiaries including but without being limited to an employees' share scheme, which does not accord to any Director any privilege or advantage not generally accorded to the employees and/or former employees to whom the arrangement relates; and
7. any transaction or arrangement with any other company, being a company in which the Director is interested only as an officer, creditor or shareholder, provided that he is not the holder of or beneficially interested in one per cent or more of the equity share capital of that company (or of any other company through which his interest is derived) and not entitled to exercise one per cent or more of the voting rights available to members of the relevant company (disregarding, for the purposes of this proviso: (i) any shares held by a Director as bare or custodian trustee and in which he has no beneficial interest; (ii) any shares comprised in an authorised unit trust scheme in which the Director is interested only as a unit holder; and (iii) any shares of that class held as treasury shares).

The Company may by ordinary resolution suspend or relax to any extent, either generally or in respect of any particular matter, any provision of the Articles prohibiting a Director from voting at a meeting of the Directors or of a committee of the Directors.

Directors: borrowing powers
Without prejudice to their general powers, the Directors may exercise all the powers of the Company to borrow money and to mortgage or charge its undertaking, property, assets (present and future) and uncalled capital or any part thereof, and (subject to the provisions of the Articles of Association) to issue debentures, debenture stock and other securities whether outright or as security for any debt, liability or obligation of the Company or of any third party.

Directors: interests
Provided that the Director has disclosed to the other Directors the nature and extent of any material interest of his, a Director, notwithstanding his office:

1. may be a party to, or otherwise interested in, any transaction or arrangement with the Company or in which the Company is otherwise interested;
2. may be a Director or other officer of, or employed by or may be a party to, or otherwise interested in, any transaction or arrangement with any body corporate promoted by the Company or in which the Company is otherwise interested;
3. shall not, by reason of his office, be accountable to the Company for any benefit which he derives from any such office or employment or from any such transaction or arrangement or from any interest in any such body corporate;
4. shall not infringe his duty to avoid a situation in which he has, or can have, a direct or indirect interest that conflicts, or may possibly conflict, with the interests of the Company as a result of any such office or employment or from any such transaction or arrangement or from any interest in any such body corporate;

5. shall not be required to disclose to the Company, or use in performing his duties as a Director of the Company, any confidential information relating to such office or employment if to make such a disclosure or use would result in a breach of duty or obligation of confidence owed by him in relation to or in connection with that office or employment;
6. may absent himself from discussions and exclude himself from information, which will or may relate to that office, employment, transaction, arrangement or interest; and
7. no such transaction or arrangement will be liable to be avoided because of any such interest or benefit.

For the purposes of the Articles, a general notice given to the Directors that he is to be regarded as having an interest of the nature and extent specified in the notice in any transaction or arrangement in which a specified person or class of persons is interested is deemed to be a disclosure that the Director has an interest in any such transaction of the nature and extent so specified.

An interest of which a Director has knowledge and of which it is unreasonable to expect him to have knowledge is not treated as an interest; an interest which consists of a Director being a Director or other officer of, or employed by any subsidiary of the Company is not deemed to be a material interest; a Director need not disclose an interest if it cannot be reasonably regarded as likely to give rise to a conflict of interest; and a Director need not disclose an interest if, or to the extent that, the other Directors are already aware of it.

A Director will no longer be regarded as having an interest in a transaction by virtue of a person connected to the Director having a relevant interest. However, the Director and the Company must still take a view each time a matter is being considered as to whether the interests of the Director's connected persons mean that a Director should be treated as interested in a transaction.

The Directors may (subject to such terms and conditions, if any, as they may think fit to impose from time to time, and subject always to their right to vary or terminate such authorisation) authorise, to the fullest extent permitted by law:

1. any matter which would otherwise result in a Director infringing his duty to avoid a situation in which he has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the Company and which may reasonably be regarded as likely to give rise to a conflict of interest (including a conflict of interest and duty or conflict of duties);
2. a Director to accept or continue in any office, employment or position in addition to his office as a Director of the Company and may authorise the manner in which a conflict of interest arising out of such office, employment or position may be dealt with, either before or at the time that such a conflict of interest arises, provided that the authorisation is only effective if:
   - i) any requirement as to the quorum at the meeting at which the matter is considered is met without counting the Director in question or any other interested Director; and
   - ii) the matter was agreed to without their voting or would have been agreed to if their votes had not been counted.

If a matter, or office, employment or position, has been authorised by the Directors then (subject to such terms and conditions, if any, as the Directors may think fit to impose from time to time, and subject always to their right to vary or terminate such authorisation or the permissions set out below):

1. the Director shall not be required to disclose any confidential information relating to such matter, or such office, employment or position, to the Company if to make such a disclosure would result in a breach of a duty or obligation of confidence owed by him in relation to or in connection with that matter, or that office, employment or position;
2. the Director may absent himself from discussions, whether in meetings of the Directors or otherwise, and exclude himself from information which will or may relate to that matter, or that office, employment or position; and
3. a Director shall not, by reason of his office as a Director of the Company, be accountable to the Company for any benefit which he derives from any such matter, or from any such office, employment or position.

Dividend rights
Holders of the Company's ordinary shares may, by ordinary resolution, declare dividends but may not declare dividends in excess of the amount recommended by the Directors. The Directors may also pay interim dividends if it appears that such dividends are justified by the profits available for distribution. No dividend shall be paid otherwise than out of profits available as specified under the provisions of the Companies Act.

The Directors may, with the sanction of an ordinary resolution of the shareholders, offer any holders of ordinary shares the right to elect to receive ordinary shares credited as fully paid instead of cash in respect of the whole or part of all such dividends as may be specified by the resolution. Any general meeting declaring a dividend may, upon the recommendation of the Directors, direct payment or satisfaction of such dividend to be wholly or partly by the distribution of specific assets. Where difficulty arises in regard to distribution, the Directors may ignore fractions or issue fractional certificates, fix the value for distribution of any assets and may determine that cash shall be paid to any shareholder in order to adjust the rights of such members.

Any dividend which has been unclaimed for 12 years from the date when it became due for payment shall, if the Directors so resolve, be forfeited and shall cease to be owed by the Company.

The Company can cease sending dividend warrants and cheques by post or otherwise if these have been returned undelivered to, or left uncashed by, the shareholder on at least two consecutive occasions, or, if following one such occasion, reasonable enquiries have failed to establish the member's new address. No dividend shall bear interest against the Company, unless provided by the rights attached to the share.

The Directors may elect to make payments of dividends to shareholders by bank or electronic transfer only. Amounts due to shareholders who provide no, or invalid, account details may be held in an account in the Company's name until such shareholders nominate a valid account. The Company shall not be a trustee of any such monies, shall be deemed to have discharged its payment

Other statutory and regulatory information (continued)

obligations by paying the relevant monies into such account and interest will not accrue for shareholders on any such monies pending payment to such persons.

Voting rights
Voting at any general meeting of shareholders is by a show of hands unless a poll is demanded. On a show of hands, every shareholder who is present in person at a general meeting has one vote regardless of the number of shares held by the shareholder.

Every proxy appointed by a shareholder and present at a general meeting has one vote, except that if the proxy has been duly appointed by more than one shareholder entitled to vote on the resolution and is instructed by one or more of those shareholders to vote for the resolution and by one or more others to vote against it, or is instructed by one or more of those shareholders to vote in one way and is given discretion as to how to vote by one or more others (and wishes to use that discretion to vote in the other way) he has one vote for and one vote against the resolution.

On a poll, every shareholder who is present in person or by proxy has one vote for every share held by the shareholder. A shareholder (or his duly appointed proxy) entitled to more than one vote need not use all his votes or cast all the votes he uses in the same way. A poll may be demanded by any of the following:

1. the Chairman of the meeting;
2. the Directors;
3. not less than five shareholders having the right to vote at the meeting;
4. a shareholder or shareholders representing not less than one-tenth of the total voting rights of all shareholders having the right to vote at the meeting (excluding any voting rights attached to treasury shares); or
5. a shareholder or shareholders holding shares which confer a right to vote on the resolution at the meeting being shares on which an aggregate sum has been paid up equal to not less than one-tenth of the total sum paid up on all shares conferring that right (excluding any voting rights attached to treasury shares).

Matters are transacted at general meetings of the Company by proposing and passing of two kinds of resolutions:

1. ordinary resolutions, which can include resolutions for the appointment, reappointment and removal of Directors, the receiving of the Annual Report, the declaration of final dividends, the appointment and reappointment of the external auditor, the authority for the Company to purchase its own shares and the grant of authority to allot shares; and
2. special resolutions, which can include resolutions amending the Company's Articles of Association and resolutions relating to certain matters concerning a winding-up of the Company.

An ordinary resolution requires the affirmative vote of a simple majority of the votes cast at a meeting at which there is a quorum in order to be passed. Special resolutions require the affirmative vote of not less than three-quarters of the votes cast at a meeting at which there is a quorum in order to be passed. The necessary quorum for a meeting of the Company is a minimum of two shareholders present in person or by proxy or by a duly authorised representative(s) of a corporation which is a shareholder and entitled to vote.

When convening a meeting the Company may specify a time not more than 48 hours before the time of the meeting (excluding any part of a day that is not a working day) by which a person must be entered on the register of members in order to have the right to attend or vote at the meeting.

Winding-up
If the Company is wound up, the liquidator may, with the sanction of a special resolution and any other sanction required by law, subject to the provisions of the Companies Act, divide among the shareholders the whole or any part of the assets of the Company, and may, for that purpose, value any assets and determine how the division is to take place as between the shareholders or different classes of shareholders. Alternatively, with the same sanction, the liquidator may vest the whole or any part of the assets in trustees upon trusts for the benefit of the shareholders, but no shareholder will be compelled to accept any asset upon which there is a liability.

Transfer of shares
Shares may be transferred by an instrument of transfer in any usual form or in any other form which the Directors may approve and shall be executed by or on behalf of the transferor and, where the share is not fully paid, by or on behalf of the transferee. The Directors can, in their absolute discretion, refuse to register the transfer of a share in certificated form which is not fully paid, provided that such a refusal would not prevent dealings in shares in certificated form which are not fully paid from taking place on a proper basis. The Directors may also refuse to register a transfer of a share in certificated form (whether fully paid or not) unless the instrument of transfer:

1. is lodged, duly stamped, and is deposited at the registered office of the Company or such other place as the Directors may appoint and is accompanied by a certificate for the shares to which it relates and such other evidence as the Directors may reasonably require to show the right of the transferor to make the transfer;
2. is in respect of only one class of share; and
3. is in favour of not more than four transferees.

In the case of uncertificated shares, transfers shall be registered only in accordance with the terms of the Uncertificated Securities Regulations 2001 so that Directors may refuse to register a transfer which would require shares to be held jointly by more than four persons.

If the Directors refuse to register a transfer of shares, they must give the transferee notice of this refusal as soon as practicable and in any event within two months of the instrument of transfer being lodged with the Company. No fees may be charged for the registration of a transfer of shares.

Pre-emptive rights and new issues of shares
While holders of ordinary shares have no pre-emptive rights under the Articles of Association, the ability of the Directors to cause the Company to issue shares, securities convertible into shares or rights to shares, otherwise than pursuant to an employee share scheme, is restricted. Under the Companies Act, the Directors of a company are, with certain exceptions, unable to allot any equity securities

without express authorisation, which may be contained in a company's Articles of Association or given by its shareholders in general meeting, but which in either event cannot last for more than five years. Under the Companies Act, a company may also not allot shares for cash (otherwise than pursuant to an employee share scheme) without first making an offer to existing shareholders to allot such shares to them on the same or more favourable terms in proportion to their respective shareholdings, unless this requirement is waived by a special resolution of the shareholders.

Alteration of share capital
The Company may, from time to time, by ordinary resolution:

1. consolidate and divide all or any of its shares into shares of a larger amount than its existing shares;
2. sub-divide any of its shares into shares of smaller amount than its existing shares; and
3. determine that, as between the shares resulting from such a sub-division, any of them may have any preference or advantage as compared with the others.

Subject to the provisions of the Companies Act:

1. the Company may reduce its share capital, its capital redemption reserve and any share premium account in any way; and
2. the Company may purchase its own shares, including redeemable shares, and may hold such shares as treasury shares or cancel them.

Disclosure of interests in the Company's shares
There are no provisions in the Articles of Association whereby persons acquiring, holding or disposing of a certain percentage of the Company's shares are required to make disclosure of their ownership percentage, although there are such requirements under statute and regulation. The basic disclosure requirement under Part 6 of the Financial Services and Markets Act 2000 and Rule 5 of the Disclosure and Transparency Rules made by the Financial Services Authority imposes a statutory obligation on a person to notify the Company and the Financial Services Authority of the percentage of the voting rights in the Company he directly or indirectly holds or controls, or has rights over, through his direct or indirect holding of certain financial instruments, if the percentage of those voting rights:

1. reaches, exceeds or falls below 3 per cent and/or any subsequent whole percentage figure as a result of an acquisition or disposal of shares or financial instruments; or
2. reaches, exceeds or falls below any such threshold as a result of any change in the number of voting rights attached to shares in the Company.

The Disclosure and Transparency Rules set out in detail the circumstances in which an obligation of disclosure will arise, as well as certain exemptions from those obligations for specified persons.

Under Section 793 of the Companies Act, the Company may, by notice in writing, require a person that the Company knows or has reasonable cause to believe is or was during the three years preceding the date of notice interested in the Company's shares, to indicate whether or not that is the case and, if that person does or did hold an interest in the Company's shares, to provide certain information as set out in that Act. The Disclosure and Transparency Rules further deal with the disclosure by persons of interests in shares or debentures of the companies of which they are Directors and certain associated companies.

The City Code on Takeovers and Mergers also imposes strict disclosure requirements with regard to dealings in the securities of an offeror or offeree company on all parties to a takeover and also on their respective associates during the course of an offer period.

General meetings and notices
An Annual General Meeting and all other general meetings of the Company must be called by at least 21 clear days' written notice. However, the Companies Act allows for this period of notice for meetings other than Annual General Meetings to be reduced to 14 clear days' notice provided that two conditions are met: (1) a company must allow shareholders to make proxy appointments via a website (such as that hosted by its share registrars); and (2) shareholders must pass a special resolution at the Annual General Meeting every year approving that shortening of the notice period to 14 days. A special resolution enabling the Company to hold general meetings (other than Annual General Meetings) on 14 days' notice will be proposed at the Annual General Meeting to be held on 28 April 2011.

Subject to the resolution being passed, the approval of the shortening of the notice period will be effective until the Company's next AGM, when it is intended that the approval be renewed. The shorter notice period would not be used as a matter of routine. Rather the Directors will consider on a case-by-case basis whether the use of the flexibility offered by the shorter notice period is merited, taking into account the circumstances, including whether the business of the meeting is time sensitive, and is thought to be to the advantage of shareholders as a whole. Further, the shorter notice period would not be used unless both of the conditions as stated above are met.

Variation of rights
If the capital of the Company is divided into different classes of shares, the rights attached to any class of shares may only be varied, either in such a manner as provided by those rights or in the absence of any provision, with the consent in writing of three-quarters in nominal value of the issued shares of that class or with the sanction of a special resolution passed at a separate meeting of holders of such shares. At any separate meeting, the necessary quorum is two persons together holding or representing by proxy at least one-third in nominal amount of the issued shares of the class (but at an adjourned meeting shall be any one person holding shares of the class or his proxy).

Unless otherwise expressly provided by the rights attached to any shares, those rights shall be deemed to be varied by the reduction of the capital paid up on those shares and by the creation or issue of further shares ranking in priority for payment of a dividend or in respect of capital or which confer on the holders voting rights more favourable than those conferred by the first-mentioned shares, but shall not otherwise be deemed to be varied by the creation or issue of further shares ranking pari passu with them or subsequent to them.

Other statutory and regulatory information (continued)

Repurchase of shares

Subject to authorisation by shareholder resolution, the Company may purchase its own shares in accordance with the Companies Act. Any shares which have been bought back may be held as treasury shares or, if not so held, must be cancelled immediately upon completion of the purchase, thereby reducing the amount of the Company's issued share capital. There is no longer a requirement for public companies to have specific authorisations in their articles of association to undertake these actions.

Creditor payment policy

Given the international nature of the Group's operations, there is not a global standard code for the Group in respect of payments to suppliers. In the UK, the operating subsidiaries have signed up to the Better Payment Practice Code under which each company undertakes to: (1) seek agreement on payment terms with its suppliers at the outset of each transaction; (2) explain its payment procedures to its suppliers; (3) pay bills in accordance with the agreed terms and all legal requirements; and (4) inform suppliers without delay when contesting an invoice and settle disputes quickly. Details of the Code are available on the website, www.payontime.co.uk

Non-UK operating subsidiaries are responsible for agreeing terms and conditions for their business transactions when orders for goods and services are placed, ensuring that suppliers are aware of the terms of payment and including the relevant terms in contracts where appropriate. These arrangements are adhered to provided that suppliers meet their contractual commitments.

Creditor days have not been calculated for the Company as it is an investment holding Company and had no trade creditors at 31 December 2010.

Intra-Group pricing

The prices agreed between Group companies for Intra-Group sales of materials, manufactured goods, charges for royalties, commissions, services and fees are based on the normal commercial practices which would apply between independent businesses.

On behalf of the Board

Nicola Snook
Secretary

23 February 2011

British American Tobacco p.l.c.
Registered in England and Wales No. 3407696

Responsibility of Directors

Directors' responsibilities in relation to the financial statements

The following statement sets out the responsibilities of the Directors in relation to the financial statements of both the Group and the Company. The reports of the independent auditors for the Group and the Company set out their responsibilities in relation to those financial statements.

Company law requires the Directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company and the Group as at the end of the financial year and of the profit or loss of the Group and the Company for the financial year. In preparing those financial statements, the Directors are required to:

- select appropriate accounting policies and apply them consistently;
- make judgments and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures being disclosed and explained; and
- prepare the financial statements on the going concern basis, unless they consider that to be inappropriate.

The applicable accounting standards referred to above are: (a) United Kingdom Generally Accepted Accounting Principles (UK GAAP) for the Company; and (b) International Financial Reporting Standards (IFRS) as adopted by the European Union and implemented in the UK for the Group.

The Directors are responsible for ensuring that the Company keeps sufficient accounting records to disclose with reasonable accuracy the financial position of the Company and the Group and to enable them to ensure that the Group financial statements comply with the Companies Act 2006 and Article 4 of the IAS Regulation, and that the Company financial statements and the Directors' Remuneration report comply with the Companies Act 2006. They are also responsible for taking reasonable steps to safeguard the assets of the Company and the Group and, in that context, having proper regard to the establishment of appropriate systems of internal control with a view to the prevention and detection of fraud and other irregularities.

The Directors are required to prepare financial statements and to provide the auditors with every opportunity to take whatever steps and undertake whatever inspections the auditors consider to be appropriate for the purpose of enabling them to give their audit report.

The Directors are responsible for the maintenance and integrity of the Annual Report on www.bat.com in accordance with the UK legislation governing the preparation and dissemination of financial statements. Access to the website is available from outside the UK, where comparable legislation may be different.

The Directors consider that they have pursued the actions necessary to meet their responsibilities as set out in this statement.

Directors' declaration in relation to relevant audit information

Having made enquiries of fellow Directors and of the Company's auditors, each of the Directors confirms that:

- to the best of his or her knowledge and belief, there is no relevant audit information of which the Company's auditors are unaware; and
- he or she has taken all steps that a Director might reasonably be expected to have taken in order to make himself or herself aware of relevant audit information and to establish that the Company's auditors are aware of that information.

Directors' responsibility statement

The Directors confirm to the best of their knowledge and belief that:

- the financial statements, prepared in accordance with the applicable accounting standards identified above, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and the Group; and
- the Directors' report (which incorporates the Business review) includes a fair review of the development and performance of the business and the position of the Group and the Company, together with a description of the principal risks and uncertainties that they face.

The names of the Directors are listed in this Directors' report and their details appear on the Board of Directors page.

Neither the Company nor the Directors accept any liability to any person in relation to this Annual Report except to the extent that such liability could arise under English law. Accordingly, any liability to a person who has demonstrated reliance on any untrue or misleading statement or omission shall be determined in accordance with section 90A of the Financial Services and Markets Act 2000.

The responsibility statement was approved by the Board of Directors on 23 February 2011 and signed on its behalf by:

Richard Burrows
Chairman

Ben Stevens
Finance Director and CIO

Independent auditors' report

To the members of British American Tobacco p.l.c.

We have audited the Group financial statements of British American Tobacco p.l.c. for the year ended 31 December 2010 which comprise the Group income statement, the Group statement of comprehensive income, the Group statement of changes in equity, the Group balance sheet, the Group cash flow statement, the notes on the accounts and the Principal subsidiary undertakings and the Principal associate undertakings. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

Respective responsibilities of Directors and auditors

As explained more fully in the Responsibility of Directors' statement set out on page 105, the Directors are responsible for the preparation of the Group financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the Group financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the Company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the financial statements.

Opinion on financial statements

In our opinion the Group financial statements:

- give a true and fair view of the state of the Group's affairs as at 31 December 2010 and of its profit and cash flows for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006 and Article 4 of the IAS Regulation.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the Group financial statements are prepared is consistent with the Group financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following:

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- certain disclosures of Directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Under the Listing Rules we are required to review:

- the Directors' statement, set out on page 63, in relation to going concern;
- the part of the Corporate governance statement relating to the Company's compliance with the nine provisions of the June 2008 Combined Code specified for our review; and
- certain elements of the report to shareholders by the Board on Directors' remuneration.

Other matter

We have reported separately on the Parent Company financial statements of British American Tobacco p.l.c. for the year ended 31 December 2010 and on the information in the Remuneration report that is described as having been audited.

Paul Cragg (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London, United Kingdom

23 February 2011

Group income statement

For the year ended 31 December

	Notes	2010 £m	2009 £m
Gross turnover (including duty, excise and other taxes of £28,972 million (2009: £26,505 million))		**43,855**	40,713
Revenue	2	**14,883**	14,208
Raw materials and consumables used		**(3,695)**	(3,983)
Changes in inventories of finished goods and work in progress		**(12)**	35
Employee benefit costs	3a	**(2,550)**	(2,317)
Depreciation, amortisation and impairment costs	3b	**(897)**	(611)
Other operating income	3c	**207**	196
Other operating expenses	3d	**(3,618)**	(3,427)
Profit from operations	2	**4,318**	4,101
Analysed as:			
– adjusted profit from operations	2	**4,984**	4,461
– restructuring and integration costs	3e	**(311)**	(304)
– amortisation of trademarks	3f	**(62)**	(58)
– impairment of trademarks	3g	**(44)**	
– goodwill impairment	3g	**(249)**	
– gains on disposal of businesses and trademarks	3h		2
		4,318	4,101
Finance income		**27**	77
Finance costs		**(507)**	(581)
Net finance costs	4	**(480)**	(504)
Share of post-tax results of associates and joint ventures	5	**550**	483
Analysed as:			
– adjusted share of post-tax results of associates and joint ventures	2	**622**	541
– trademark amortisation and impairments	5	**(1)**	(65)
– health plan credit	5		16
– Canadian settlements	5	**(59)**	
– dilution in shareholding	5	**(9)**	
– restructuring costs	5	**(3)**	(9)
		550	483
Profit before taxation		**4,388**	4,080
Taxation on ordinary activities	6	**(1,248)**	(1,124)
Profit for the year		**3,140**	2,956
Attributable to:			
Owners of the parent		**2,879**	2,713
Non-controlling interests		**261**	243
		3,140	2,956
Earnings per share			
Basic	7	**145.2p**	137.0p
Diluted	7	**144.4p**	136.3p

All of the activities during both years are in respect of continuing operations.

The accompanying notes are an integral part of the Group financial statements.

Group statement of comprehensive income

For the year ended 31 December

	Notes	2010 £m	2009 £m
Profit for the year (page 107)		**3,140**	2,956
Other comprehensive income			
Differences on exchange			
– subsidiaries		**502**	166
– associates		**105**	(258)
Differences on exchange reclassified and reported in profit for the year		**(3)**	
Cash flow hedges			
– net fair value losses		**(106)**	(72)
– reclassified and reported in profit for the year		**55**	67
– reclassified and reported in net assets		**3**	(1)
Available-for-sale investments			
– net fair value gains		**4**	3
– reclassified and reported in profit for the year			(3)
Net investment hedges			
– net fair value (losses)/gains		**(31)**	238
– differences on exchange on borrowings		**74**	12
Retirement benefit schemes			
– net actuarial gains/(losses) in respect of subsidiaries	12	**193**	(295)
– surplus recognition and minimum funding obligations in respect of subsidiaries	12	**58**	(76)
– actuarial (losses)/gains in respect of associates net of tax	11	**(54)**	61
Tax on items recognised directly in other comprehensive income	6d	**1**	(71)
Total other comprehensive income for the year, net of tax		**801**	(229)
Total comprehensive income for the year, net of tax		**3,941**	2,727
Attributable to:			
Owners of the parent		**3,664**	2,476
Non-controlling interests		**277**	251
		3,941	2,727

The accompanying notes are an integral part of the Group financial statements.

Group statement of changes in equity

At 31 December

	Notes	Share capital £m	Share premium, capital redemption and merger reserves £m	Other reserves £m	Retained earnings £m	Total attributable to owners of parent £m	Non-controlling interests £m	Total equity £m
		Attributable to owners of the parent						
Balance at 1 January 2010		**506**	**3,907**	**1,032**	**2,168**	**7,613**	**299**	**7,912**
Total comprehensive income for the year (page 108)				**568**	**3,096**	**3,664**	**277**	**3,941**
Employee share options								
– value of employee services					**67**	**67**		**67**
– proceeds from shares issued			**3**		**4**	**7**		**7**
Dividends and other appropriations								
– ordinary shares					**(2,093)**	**(2,093)**		**(2,093)**
– to non-controlling interests							**(234)**	**(234)**
Purchase of own shares								
– held in employee share ownership trusts					**(66)**	**(66)**		**(66)**
Non-controlling interests – acquisitions	29				**(12)**	**(12)**		**(12)**
Other movements					**26**	**26**		**26**
Balance at 31 December 2010		**506**	**3,910**	**1,600**	**3,190**	**9,206**	**342**	**9,548**

	Notes	Share capital £m	Share premium, capital redemption and merger reserves £m	Other reserves £m	Retained earnings £m	Total attributable to owners of parent £m	Non-controlling interests £m	Total equity £m
		Attributable to owners of the parent						
Balance at 1 January 2009		506	3,905	955	1,578	6,944	271	7,215
Total comprehensive income for the year (page 108)				77	2,399	2,476	251	2,727
Employee share options								
– value of employee services					61	61		61
– proceeds from shares issued			2		5	7		7
Dividends and other appropriations								
– ordinary shares					(1,798)	(1,798)		(1,798)
– to non-controlling interests							(240)	(240)
Purchase of own shares								
– held in employee share ownership trusts					(94)	(94)		(94)
Non-controlling interests – acquisitions	26						1	1
Non-controlling interests – capital injection	29						16	16
Other movements					17	17		17
Balance at 31 December 2009		506	3,907	1,032	2,168	7,613	299	7,912

The accompanying notes are an integral part of the Group financial statements.

Group balance sheet

At 31 December

	Notes	2010 £m	2009 £m
Assets			
Non-current assets			
Intangible assets	9	**12,458**	12,232
Property, plant and equipment	10	**3,117**	3,010
Investments in associates and joint ventures	11	**2,666**	2,521
Retirement benefit assets	12	**122**	105
Deferred tax assets	13	**411**	350
Trade and other receivables	14	**272**	171
Available-for-sale investments	15	**29**	26
Derivative financial instruments	16	**128**	93
Total non-current assets		**19,203**	18,508
Current assets			
Inventories	17	**3,608**	3,261
Income tax receivable	18	**73**	97
Trade and other receivables	14	**2,409**	2,344
Available-for-sale investments	15	**58**	57
Derivative financial instruments	16	**145**	156
Cash and cash equivalents	19	**2,329**	2,161
		8,622	8,076
Assets classified as held-for-sale	26	**35**	30
Total current assets		**8,657**	8,106
Total assets		**27,860**	26,614

	Notes	2010 £m	2009 £m
Equity			
Capital and reserves			
Share capital		**506**	506
Share premium, capital redemption and merger reserves		**3,910**	3,907
Other reserves		**1,600**	1,032
Retained earnings		**3,190**	2,168
Owners of the parent		**9,206**	7,613
after deducting			
– cost of treasury shares		**(750)**	(772)
Non-controlling interests		**342**	299
Total equity	20	**9,548**	7,912
Liabilities			
Non-current liabilities			
Borrowings	21	**8,916**	9,712
Retirement benefit liabilities	12	**770**	1,129
Deferred tax liabilities	13	**509**	527
Other provisions for liabilities and charges	22	**187**	144
Trade and other payables	23	**193**	180
Derivative financial instruments	16	**92**	94
Total non-current liabilities		**10,667**	11,786
Current liabilities			
Borrowings	21	**1,334**	1,370
Income tax payable	18	**467**	364
Other provisions for liabilities and charges	22	**282**	312
Trade and other payables	23	**5,335**	4,727
Derivative financial instruments	16	**227**	127
		7,645	6,900
Liabilities directly associated with assets classified as held-for-sale	26		16
Total current liabilities		**7,645**	6,916
Total equity and liabilities		**27,860**	26,614

The accompanying notes are an integral part of the Group financial statements.

On behalf of the Board

Richard Burrows
Chairman

23 February 2011

Group cash flow statement

For the year ended 31 December

	Notes	2010 £m	2009 £m
Cash flows from operating activities			
Cash generated from operations	25	**5,207**	4,645
Dividends received from associates		**461**	328
Tax paid		**(1,178)**	(1,095)
Net cash from operating activities		**4,490**	3,878
Cash flows from investing activities			
Interest received		**59**	83
Dividends received from investments		**2**	2
Purchases of property, plant and equipment		**(497)**	(450)
Proceeds on disposal of property, plant and equipment		**61**	39
Purchases of intangibles		**(87)**	(104)
Purchases and proceeds on disposals of investments	25	**(1)**	37
Purchase of Bentoel	25		(370)
Purchase of Tekel cigarette assets	25		(12)
Proceeds from ST trademark disposals	25		187
Purchases of other subsidiaries and associates	25		(1)
Proceeds on disposal of subsidiaries	25	**12**	
Net cash from investing activities		**(451)**	(589)
Cash flows from financing activities			
Interest paid		**(578)**	(576)
Interest element of finance lease rental payments		**(2)**	(2)
Capital element of finance lease rental payments		**(17)**	(35)
Proceeds from issue of shares to owners of the parent		**3**	2
Proceeds from the exercise of options over own shares held in employee share ownership trusts		**4**	5
Proceeds from increases in and new borrowings	25	**892**	1,447
Movements relating to derivative financial instruments	25	**(179)**	(267)
Purchases of own shares held in employee share ownership trusts		**(66)**	(94)
Purchases of non-controlling interests	25	**(12)**	
Reductions in and repayments of borrowings	25	**(1,582)**	(1,853)
Dividends paid to owners of the parent	8	**(2,093)**	(1,798)
Dividends paid to non-controlling interests		**(234)**	(234)
Net cash from financing activities		**(3,864)**	(3,405)
Net cash flows from operating, investing and financing activities		**175**	(116)
Differences on exchange		**29**	(125)
Increase/(decrease) in net cash and cash equivalents in the year		**204**	(241)
Net cash and cash equivalents at 1 January		**1,979**	2,220
Net cash and cash equivalents at 31 December	19	**2,183**	1,979

The accompanying notes are an integral part of the Group financial statements.

Notes on the accounts

1 Accounting policies

Basis of Accounting

The Group financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union and with those parts of the Companies Act 2006 applicable to companies reporting under IFRS.

The financial statements have been prepared under the historical cost convention except as described in the accounting policy below on financial instruments.

The Group has adopted the following new and amended IFRSs and IFRIC interpretations with effect from 1 January 2010.

- The revised IFRS 3 (Business Combinations) and IAS 27 (Consolidated and Separate Financial Statements) change the accounting for business combinations and transactions with non-controlling interests. These revised standards are only to be applied prospectively and so there is no restatement of transactions prior to the effective date. IFRS 3 Revised has had no impact on the current period. IAS 27 Revised was applied to the acquisition of certain non-controlling interests in the year with the difference between the fair value of the consideration paid and the carrying value of the non-controlling interest recognised directly in equity. Goodwill is no longer recognised on acquisition of non-controlling interests where there is no change in control.
  Also in accordance with IAS 27 Revised, losses in the current year applicable to non-controlling interests, where their share of accumulated losses exceed their interest in the equity of a subsidiary, are no longer allocated to the owners of the parent except to the extent that the Group has a binding obligation to cover the losses.
- Annual Improvements to IFRS (issued in April 2009) introduce a number of minor changes including revised disclosures under IFRS 8. As a result of this amendment, the Group no longer presents a measure of total assets for each reportable segment as information on total assets and liabilities is not reported to the chief operating decision maker.
- In addition, a number of other interpretations and revisions to existing standards have been issued and endorsed which have had no effect on reported profit or equity or on the disclosures in the financial statements.

The preparation of the Group financial statements requires management to make estimates and assumptions that affect the reported amounts of revenues, expenses, assets and liabilities, and the disclosure of contingent liabilities at the date of the financial statements. The key estimates and assumptions are set out in the accounting policies below, together with the related notes to the accounts.

The most significant items include:

- the review of asset values, especially goodwill and impairment testing. The key assumptions used in respect of goodwill and impairment testing are the determination of cash-generating units, the long-term growth rate for cash flow projections and the rate used to discount the cash flow projections. These are described in note 9;
- the estimation of and accounting for retirement benefit costs. The determination of the carrying value of assets and liabilities, as well as the charge for the year, and amounts recognised in other comprehensive income, involves judgments made in conjunction with independent actuaries. These involve estimates about uncertain future events based on the environment in different countries, including life expectancy of scheme members, salary and pension increases, inflation and expected returns on assets, as well as discount rates and asset values at the year end. The assumptions used by the Group and sensitivity analysis are described in note 12;
- the estimation of amounts to be recognised in respect of taxation and legal matters, and the estimation of other provisions for liabilities and charges are subject to uncertain future events, may extend over several years and so the amount and/or timing may differ from current assumptions. The accounting policy for taxation is explained below and the recognised deferred tax assets and liabilities, together with a note of unrecognised amounts, are shown in note 6(b) and note 13. Other provisions for liabilities and charges are as set out in note 22. The accounting policy on contingent liabilities, which are not provided for, is set out below and the contingent liabilities of the Group are explained in note 30;
- the definition of adjusting items, which are separately disclosed as memorandum information, is explained below and the impact of these on the calculation of adjusted earnings is described in note 7;
- the estimation of the fair values of acquired net assets arising in a business combination under IFRS 3 Revised and the allocation of the purchase consideration between the underlying net assets acquired, including intangible assets other than goodwill, on the basis of their fair values. These estimates are prepared in conjunction with the advice of independent valuation experts where appropriate. The relevant transactions for 2009 are described in note 26; and
- the exemptions taken under IFRS 1 on the first time adoption of IFRS at 1 January 2004 and, in particular, those relating to goodwill on business combinations which are explained in the accounting policies below.

Such estimates and assumptions are based on historical experience and various other factors that are believed to be reasonable in the circumstances and constitute management's best judgment at the date of the financial statements. In the future, actual experience may deviate from these estimates and assumptions, which could affect the financial statements as the original estimates and assumptions are modified, as appropriate, in the year in which the circumstances change.

Basis of consolidation

The consolidated financial information includes the financial statements of British American Tobacco p.l.c. and its subsidiary undertakings, together with the Group's share of the results of its associates and joint ventures.

Notes on the accounts (continued)

1 Accounting policies continued

A subsidiary is an entity controlled by the Group, where control is the power to govern the financial and operating policies of the entity so as to obtain benefit from its activities.

Associates and joint ventures comprise investments in undertakings, which are not subsidiary undertakings, where the Group's interest in the equity capital is long term and over whose operating and financial policies the Group exercises a significant influence and, in the case of joint ventures, has joint control. They are accounted for using the equity method.

The results of subsidiary undertakings acquired during the period are included from the date of acquisition of a controlling interest at which date, for the purposes of consolidation, the purchase consideration is allocated between the underlying net assets acquired, including intangible assets other than goodwill, on the basis of their fair value. Similarly, the results of associates and joint ventures are included from the date of acquiring significant influence or, in the case of joint ventures, joint control.

The results of subsidiary undertakings, associates and joint ventures which have been sold during the year are included up to the date of disposal. The profit or loss on sale is calculated by reference to the net asset value at the date of disposal, adjusted for purchased goodwill previously consolidated in the balance sheet.

Up to 31 December 2009, where accumulated losses applicable to a non-controlling interest exceeded their interest in the equity of a subsidiary, the excess was allocated to the Group's interest in the subsidiary, except to the extent that the minority had a binding obligation and was able to make an additional investment to cover the losses. From 1 January 2010, losses in the current year applicable to non-controlling interests are not reallocated unless the Group has a binding obligation to cover the losses.

Inter-company balances and transactions, and any unrealised gains arising from inter-company transactions, are eliminated in preparing the consolidated financial statements.

Foreign currencies

The functional currency of the Parent Company is sterling and this is also the presentation currency of the Group. The income and cash flow statements of Group undertakings expressed in currencies other than sterling are translated to sterling using exchange rates applicable to the dates of the underlying transactions. Average rates of exchange in each year are used where the average rate approximates the relevant exchange rate at the date of the underlying transactions. Assets and liabilities of Group undertakings are translated at the applicable rates of exchange at the end of each year. For hyperinflationary countries, the financial statements in local currency are adjusted to reflect the impact of local inflation prior to translation into sterling.

The differences between retained profits of overseas subsidiary undertakings, associates and joint ventures translated at average and closing rates of exchange are taken to reserves, as are differences arising on the retranslation to sterling (using closing rates of exchange) of overseas net assets at the beginning of the year. Any differences that have arisen since 1 January 2004 are presented as a separate component of equity. As permitted under IFRS 1, any differences prior to that date are not included in this separate component of equity. Where a disposal of an investment in a Group undertaking results in a loss of control of a subsidiary undertaking, the loss of significant influence over an associated company or the loss of joint control over a joint venture, the cumulative amount of the related foreign exchange differences deferred in the separate component of equity are recognised in the income statement when the gain or loss on disposal is recognised. These related exchange differences comprise the exchange differences on all amounts deemed to be part of the net investment in the undertaking, which are recycled to the income statement when a disposal occurs. For partial disposals of subsidiary undertakings the related exchange differences are reclassified within equity. For all other partial disposals the proportional share of the related exchange differences is recycled to the income statement.

Foreign currency transactions are initially recognised in the functional currency of each entity in the Group using the exchange rate ruling at the date of the transaction. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation of foreign currency assets and liabilities at year end rates of exchange are recognised in the income statement, except when deferred in equity as qualifying cash flow hedges, on inter-company net investment loans and qualifying net investment hedges. Foreign exchange gains or losses recognised in the income statement are included in profit from operations or net finance costs depending on the underlying transactions that gave rise to these exchange differences.

Revenue

Revenue principally comprises sales of cigarettes, cigars, leaf and other tobacco products to external customers. Revenue excludes duty, excise and other taxes and is after deducting rebates, returns and other similar discounts. Revenue is recognised when the significant risks and rewards of ownership are transferred to a third party.

Retirement benefit costs

The Group operates both defined benefit and defined contribution schemes. The net deficit or surplus for each defined benefit pension scheme is calculated in accordance with IAS 19, based on the present value of the defined benefit obligation at the balance sheet date less the fair value of the scheme assets adjusted, where appropriate, for any surplus restrictions or the effect of minimum funding requirements.

Actuarial gains and losses, changes in unrecognised scheme surpluses and minimum funding requirements are recognised in full through other comprehensive income.

Past service costs resulting from enhanced benefits are expensed over the period to vesting and if they vest immediately, then they are recognised at that time in the income statement.

The Group also has certain post-retirement healthcare schemes and they are accounted for on a similar basis to the defined benefit pension schemes.

For defined benefit schemes, the actuarial cost charged to profit from operations consists of current service cost, interest cost, expected return on plan assets, past service cost and the impact of any settlements or curtailments.

Some benefits are provided through defined contribution schemes and payments to these are charged as an expense as they fall due.

1 Accounting policies continued

Share-based payments
The Group has equity-settled and cash-settled share-based compensation plans.

Equity-settled share-based payments are measured at fair value at the date of grant. The fair value determined at the grant date of the equity-settled share-based payments is expensed over the vesting period, based on the Group's estimate of awards that will eventually vest. For plans where vesting conditions are based on total shareholder returns, the fair value at date of grant reflects these conditions, whereas earnings per share vesting conditions are reflected in the calculation of awards that will eventually vest over the vesting period. For cash-settled share-based payments, a liability equal to the portion of the services received is recognised at its current fair value determined at each balance sheet date. Fair value is measured by the use of the Black-Scholes option pricing model, except where vesting is dependent on market conditions when the Monte-Carlo option pricing model is used. The expected life used in the models has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions and behavioural considerations.

Research and development
Research expenditure is charged to income in the year in which it is incurred. Development expenditure is charged to income in the year it is incurred, unless it meets the recognition criteria of IAS 38 (Intangible Assets).

Taxation
Taxation is that chargeable on the profits for the period, together with deferred taxation.

The current income tax charge is calculated on the basis of tax laws enacted or substantially enacted at the balance sheet date in the countries where the Group's subsidiaries, associates and joint ventures operate and generate taxable income.

Deferred taxation is provided in full using the liability method for temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amount used for taxation purposes. Deferred tax is provided on temporary differences arising on investments in Group undertakings, except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that it will not reverse in the foreseeable future. A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. As required under IAS 12, deferred tax assets and liabilities are not discounted.

Deferred tax is determined using the tax rates that have been enacted or substantively enacted by the balance sheet date and are expected to apply when the related deferred tax asset is realised or deferred tax liability is settled.

Tax is recognised in the income statement except to the extent that it relates to items recognised in other comprehensive income or directly in equity, in which case it is recognised in other comprehensive income or changes in equity.

The Group has exposures in respect of the payment or recovery of a number of taxes. Liabilities or assets for these payments or recoveries are recognised at such time as an outcome becomes probable and when the amount can reasonably be estimated.

Goodwill
Goodwill arising on acquisitions is capitalised and is considered to have an indefinite life subject to impairment reviews. Any impairment of goodwill is recognised immediately in the income statement and is not subsequently reversed.

Goodwill represents the excess of the cost of acquisition of a subsidiary, associate or joint venture over the Group's share of the fair value of identifiable net assets acquired. Goodwill is stated at cost less accumulated impairment losses and amortisation prior to 1 January 2004.

The Group's policy up to and including 1997 was to eliminate goodwill against reserves. Goodwill acquired from 1998 to 31 December 2003 was capitalised and amortised over its useful economic life. As permitted under IFRS 1, in respect of acquisitions prior to 1 January 2004, the classification and accounting treatment of business combinations was not amended on transition to IFRS. Goodwill previously written off direct to reserves is not recycled to the income statement on the disposal of the subsidiary, associate or joint venture to which it relates.

Goodwill in respect of subsidiaries is included in intangible assets. In respect of associates and joint ventures, goodwill is included in the carrying value of the investment in the associated company or joint venture. On disposal of a subsidiary, associate or joint venture, the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

Intangible assets other than goodwill
The intangible assets shown on the Group balance sheet consist mainly of trademarks acquired by the Group's subsidiary undertakings and computer software.

Acquired trademarks are carried at cost less accumulated amortisation and impairment. Trademarks with indefinite lives are not amortised but are reviewed annually for impairment. Intangible assets other than goodwill classified as held-for-sale are not amortised. Other trademarks are amortised on a straight-line basis over their remaining useful lives, consistent with the pattern of economic benefits expected to be received, which do not exceed 20 years. Any impairments of trademarks are recognised in the income statement but increases in trademark values are not recognised.

Computer software is carried at cost less accumulated amortisation and impairment, and is amortised on a straight-line basis over periods ranging from three years to seven years.

Notes on the accounts (continued)

1 Accounting policies continued

The investments in associates and joint ventures shown in the Group balance sheet include trademarks arising from the combination of Brown & Williamson (B&W) and R J Reynolds (RJR) in 2004 to form Reynolds American Inc. (RAI), as well as those arising on the acquisition of Conwood by RAI in 2006. As the combination of B&W and RJR for the Group involved the partial disposal of B&W and an investment in RAI, fair values were assigned to trademarks formerly owned by RJR but not to those formerly owned by B&W. Most of the carrying value of the trademarks relates to trademarks which are deemed to have indefinite lives and each trademark is subject to an annual impairment test. Certain minor trademarks are being amortised over their remaining lives.

Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation and impairment. Depreciation is calculated on a straight-line basis to write off the assets over their useful economic life. No depreciation is provided on freehold land or assets classified as held-for-sale. Freehold and leasehold property are depreciated at rates between 2.5 per cent and 4 per cent per annum, and plant and equipment at rates between 7 per cent and 25 per cent per annum.

Capitalised interest

Borrowing costs which are directly attributable to the acquisition, construction or production of intangible assets or plant, property and equipment that takes a substantial period of time to get ready for its intended use or sale, and for which the commencement date for capitalisation is on or after 1 January 2009, are capitalised as part of the cost of the asset, in accordance with IAS 23 Revised (Borrowing costs). The Group's previous policy was to expense such borrowing costs as they were incurred.

Leased assets

Assets where the Group has substantially all the risks and rewards of ownership of the leased asset are classified as finance leases and are included as part of property, plant and equipment. Finance lease assets are initially recognised at an amount equal to the lower of their fair value and the present value of the minimum lease payments at inception of the lease, then depreciated over the shorter of the lease term and their estimated useful lives. Leasing payments consist of capital and finance charge elements and the finance element is charged to the income statement.

Rental payments under operating leases are charged to the income statement on a straight-line basis over the lease term.

Where arrangements are entered into which, while they are not in the legal form of a lease, are in substance a lease under IFRIC 4, then they are recognised on the same basis as the leased assets above.

Impairment of non-financial assets

Assets are reviewed for impairment whenever events indicate that the carrying amount of a cash-generating unit may not be recoverable. In addition, assets that have indefinite useful lives are tested annually for impairment. An impairment loss is recognised to the extent that the carrying value exceeds the higher of the asset's fair value less costs to sell and its value in use.

A cash-generating unit is the smallest identifiable group of assets that generates cash flows which are largely independent of the cash flows from other assets or groups of assets. At the acquisition date, any goodwill acquired is allocated to the relevant cash-generating unit or group of cash-generating units expected to benefit from the acquisition for the purpose of impairment testing of goodwill.

Impairment of financial assets

Financial assets are reviewed at each balance sheet date, or whenever events indicate that the carrying amount may not be recoverable. In the case of equity investments classified as available-for-sale, a significant or prolonged decline in the fair value of the investment below its cost is considered as an indicator that the investment is impaired.

Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is based on the weighted average cost incurred in acquiring inventories and bringing them to their existing location and condition, which will include raw materials, direct labour and overheads, where appropriate. Net realisable value is the estimated selling price less costs to completion and sale. Tobacco inventories which have an operating cycle that exceeds 12 months are classified as current assets, consistent with recognised industry practice.

Financial instruments

Financial assets and financial liabilities are recognised when the Group becomes a party to the contractual provisions of the relevant instrument and derecognised when it ceases to be a party to such provisions. Such assets and liabilities are classified as current if they are expected to be realised or settled within 12 months after the balance sheet date. If not, they are classified as non-current.

Financial assets and financial liabilities are initially recognised at fair value, plus directly attributable transaction costs where applicable, with subsequent measurement as set out below.

Non-derivative financial assets are classified on initial recognition as available-for-sale investments, loans and receivables or cash and cash equivalents as follows:

Available-for-sale investments: available-for-sale investments are those non-derivative financial assets that cannot be classified as loans and receivables or cash and cash equivalents.

Loans and receivables: these are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market.

Cash and cash equivalents: cash and cash equivalents include cash in hand and deposits held on call, together with other short-term highly liquid investments including investments in certain money market funds. Cash equivalents normally comprise instruments with maturities of three months or less at date of acquisition. In the cash flow statement, cash and cash equivalents are shown net of bank overdrafts, which are included as current borrowings in the liabilities section on the balance sheet.

1 Accounting policies continued

Apart from available-for-sale investments, non-derivative financial assets are stated at amortised cost using the effective interest method, subject to reduction for allowances for estimated irrecoverable amounts. These estimates for irrecoverable amounts are recognised when there is objective evidence that the full amount receivable will not be collected according to the original terms of the asset. Such evidence might include financial difficulties of the debtor, defaults of payment or significant overdue balances. For interest-bearing assets, their carrying value includes accrued interest receivable. Available-for-sale investments are stated at fair value, with changes in fair value being recognised directly in other comprehensive income. When such investments are derecognised (e.g. through disposal) or become impaired, the accumulated gains and losses, previously recognised in other comprehensive income, are reclassified to the income statement within 'finance income'. Dividend and interest income on available-for-sale investments are included within 'finance income' when the Group's right to receive payments is established.

Fair values for quoted investments are based on observable market prices. If there is no active market for a financial asset, the fair value is established by using valuation techniques principally involving discounted cash flow analysis.

Non-derivative financial liabilities are stated at amortised cost using the effective interest method. For borrowings, their carrying value includes accrued interest payable, as well as unamortised issue costs.

Derivative financial assets and liabilities are initially recognised, and subsequently measured, at fair value, which includes accrued interest receivable and payable where relevant. Changes in their fair values are recognised as follows:

- for derivatives that are designated as cash flow hedges, the changes in their fair values are recognised directly in other comprehensive income, to the extent that they are effective, with the ineffective portion being recognised in the income statement. Where the hedged item results in a non-financial asset, the accumulated gains and losses, previously recognised in other comprehensive income, are included in the initial carrying value of the asset (basis adjustment) and recognised in the income statement in the same periods as the hedged item. Where the underlying transaction does not result in such an asset, the accumulated gains and losses are reclassified to the income statement in the same periods as the hedged item;
- for derivatives that are designated as fair value hedges, the carrying value of the hedged item is adjusted for the fair value changes attributable to the risk being hedged, with the corresponding entry being made in the income statement. The changes in fair value of these derivatives are also recognised in the income statement;
- for derivatives that are designated as hedges of net investments in foreign operations, the changes in their fair values are recognised directly in other comprehensive income, to the extent that they are effective, with the ineffective portion being recognised in the income statement. Where non-derivatives such as foreign currency borrowings are designated as net investment hedges, the relevant exchange differences are similarly recognised. The accumulated gains and losses are reclassified to the income statement when the foreign operation is disposed of; and
- for derivatives that do not qualify for hedge accounting or are not designated as hedges, the changes in their fair values are recognised in the income statement in the period in which they arise.

In order to qualify for hedge accounting, the Group is required to document prospectively the relationship between the item being hedged and the hedging instrument. The Group is also required to demonstrate an assessment of the relationship between the hedged item and the hedging instrument, which shows that the hedge will be highly effective on an ongoing basis. This effectiveness testing is reperformed periodically to ensure that the hedge has remained, and is expected to remain, highly effective.

Hedge accounting is discontinued when a hedging instrument is derecognised (e.g. through expiry or disposal), or no longer qualifies for hedge accounting. Where the hedged item is a highly probable forecast transaction, the related gains and losses remain in equity until the transaction takes place, when they are reclassified to the income statement in the same manner as for cash flow hedges as described above. When a hedged future transaction is no longer expected to occur, any related gains and losses, previously recognised in other comprehensive income, are immediately reclassified to the income statement.

Derivative fair value changes recognised in the income statement are either reflected in arriving at profit from operations (if the hedged item is similarly reflected) or in finance costs.

Dividends

Final dividend distributions to the Company's shareholders are recognised as a liability in the Group's financial statements in the period in which the dividends are approved by the Company's shareholders at the Annual General Meeting, while interim dividend distributions are recognised in the period in which the dividends are declared and paid.

Segmental analysis

The Group is organised and managed on the basis of its geographic regions. These are the reportable segments for the Group as they form the focus of the Group's internal reporting systems and are the basis used by the chief operating decision maker, identified as the Management Board, for assessing performance and allocating resources.

The Group is a single product business providing cigarettes and other tobacco products. While the Group has clearly differentiated brands, global segmentation between a wide portfolio of brands is not part of the regular internally reported financial information.

The prices agreed between Group companies for intra-group sales of materials, manufactured goods, charges for royalties, commissions, services and fees, are based on normal commercial practices which would apply between independent businesses. Royalty income, less related expenditure, is included in the region in which the licensor is based.

Notes on the accounts (continued)

1 Accounting policies continued

Adjusting items
Adjusting items are significant items in the profit from operations, net finance costs, taxation and the Group's share of the post-tax results of associates and joint ventures which individually or, if of a similar type, in aggregate, are relevant to an understanding of the Group's underlying financial performance. While the disclosure of adjusting items is not required by IFRS, these items are separately disclosed either as memorandum information on the face of the income statement and in the segmental analyses, or in the notes to the accounts as appropriate. The Group believes that these items are useful to users of the Group financial statements in helping them to understand the underlying business performance and are used to derive the Group's principal non-GAAP measure which is adjusted diluted earnings per share.

Provisions
Provisions are recognised when either a legal or constructive obligation as a result of a past event exists at the balance sheet date, it is probable that an outflow of economic resources will be required to settle the obligation and a reasonable estimate can be made of the amount of the obligation.

Contingent liabilities and contingent assets
Subsidiaries and associates and joint ventures companies are defendants in tobacco-related and other litigation. Provision for this litigation would be made at such time as an unfavourable outcome became probable and the amount could be reasonably estimated.

Contingent assets are possible assets whose existence will only be confirmed by future events not wholly within the control of the entity and are not recognised as assets until the realisation of income is virtually certain.

The Group records its external legal fees and other external defence costs for tobacco-related and other litigation as these costs are incurred.

Repurchase of share capital
When share capital is repurchased the amount of consideration paid, including directly attributable costs, is recognised as a deduction from equity. Repurchased shares which are not cancelled, or shares purchased for the employee share ownership trusts, are classified as treasury shares and presented as a deduction from total equity.

Future changes to accounting policies
Certain changes to IFRS will be applicable for the Group accounts in future years. Set out below are those which are considered to affect the Group.

IFRS 9 Financial Instruments has been issued. This standard represents the first phase of the IASB's project to replace IAS 39 Financial Instruments: Recognition and Measurement, and has mandatory application for accounting periods beginning on or after 1 January 2013. In its current form, it sets out the classification and measurement criteria for financial assets and financial liabilities. It requires all financial assets, including assets currently classified under IAS 39 as available-for-sale, to be measured at fair value through profit and loss unless the assets can be classified as held at amortised cost. Qualifying equity investments held at fair value may have their fair value changes taken through other comprehensive income by election. Where the fair value option for certain financial liabilities is applied, the portion of fair value changes representing own credit risk would be recognised through other comprehensive income rather than the income statement. The Group does not use the fair value option for financial liabilities. The effect of applying the standard in its current form is not considered to have a material impact on the Group's reported profit or equity. These changes have not been endorsed by the European Union and will only become applicable once that endorsement has occurred.

The Annual Improvements to IFRS (issued in May 2010) have varying application dates commencing with annual periods ending on or after 1 July 2010. The main effect of these amendments is to amend certain disclosures regarding credit and other risks in respect of financial instruments. These changes have not been endorsed by the European Union and will only become applicable once that endorsement has occurred.

In addition, a number of other interpretations and revisions to existing standards have been issued which will be applicable to the Group financial statements in future years and which will have no material effect on reported profit or equity or on the disclosures in the financial statements.

2 Segmental analyses

As the chief operating decision maker, the Management Board reviews external revenues and adjusted profit from operations to evaluate segment performance and allocate resources. Interest income, interest expense and taxation are centrally managed and accordingly such items are not presented by segment as they are excluded from the measure of segment profitability.

The Management Board reviews current and prior year segmental revenue, adjusted profit from operations of subsidiaries and adjusted post-tax results of associates and joint ventures at constant rates of exchange. The constant rate comparison provided for reporting segment information is based on a retranslation, at prior year exchange rates, of the current year results of the Group's overseas entities but, other than in exceptional circumstances, does not adjust for transactional gains and losses in operations which are generated by movements in exchange rates. As a result, the 2010 segmental results were translated using the 2009 average rates of exchange. The 2009 comparative figures are also stated at the 2009 average rates of exchange.

The analyses of revenue for the 12 months to 31 December 2010 and 31 December 2009, based on location of sales, are as follows:

			2010	2009
	Revenue Constant rates £m	Translation exchange £m	Revenue Current rates £m	Revenue £m
Asia-Pacific	3,448	311	3,759	3,270
Americas	3,202	296	3,498	3,156
Western Europe	3,486	(67)	3,419	3,884
Eastern Europe	1,726	(40)	1,686	1,628
Africa and Middle East	2,401	120	2,521	2,270
Revenue	14,263	620	14,883	14,208

The analyses of profit from operations and the Group's share of the post-tax results of associates and joint ventures, reconciled to profit before taxation, are as follows:

					2010			2009
	Adjusted* segment result Constant rates £m	Translation exchange** £m	Adjusted* segment result Current rates £m	Adjusting items £m	Segment result Current rates £m	Adjusted* segment result £m	Adjusting items £m	Segment result £m
Asia-Pacific	1,195	137	1,332	(56)	1,276	1,148	(59)	1,089
Americas	1,248	134	1,382	(36)	1,346	1,186	(51)	1,135
Western Europe	1,081	(27)	1,054	(236)	818	994	(188)	806
Eastern Europe	428	(70)	358		358	409	(16)	393
Africa and Middle East	793	65	858	(338)	520	724	(46)	678
Profit from operations	4,745	239	4,984	(666)	4,318	4,461	(360)	4,101
Net finance costs					(480)			(504)
Asia-Pacific	194	14	208	(9)	199	148		148
Americas	407	5	412	(63)	349	391	(58)	333
Africa and Middle East	2		2		2	2		2
Share of post-tax results of associates and joint ventures	603	19	622	(72)	550	541	(58)	483
Profit before taxation					4,388			4,080

* The adjustments to profit from operations and the Group's share of the post-tax results of associates and joint ventures are explained in notes 3(e) to 3(h) and in note 5, respectively.

** Translation exchange in Eastern Europe includes exceptional transactional exchange losses in respect of the Group's subsidiary in Uzbekistan.

Notes on the accounts (continued)

2 Segmental analyses continued

Adjusted profit from operations at constant rates of £4,745 million (2009: £4,461 million) excludes impairment of intangibles and property, plant and equipment, as well as amortisation of trademarks. These are treated as adjusting items as explained in notes 3(b) and 3(e) to (g) and are excluded from segmental profit from operations at constant rates as follows:

	2010					2009		
	Adjusted depreciation and amortisation Constant rates £m	Translation exchange £m	Adjusted depreciation and amortisation Current rates £m	Adjusting items comprising impairment and amortisation of trademarks £m	Depreciation, amortisation and impairment Current rates £m	Adjusted depreciation and amortisation £m	Adjusting items comprising impairment and amortisation of trademarks £m	Depreciation, amortisation and impairment £m
Asia-Pacific	91	7	98	26	124	112	21	133
Americas	98	9	107		107	104	18	122
Western Europe	125	(1)	124	104	228	124	96	220
Eastern Europe	50	1	51		51	53	7	60
Africa and Middle East	60	2	62	325	387	53	23	76
	424	18	442	455	897	446	165	611

External revenue and non-current assets other than financial instruments, deferred tax assets and retirement benefit assets are analysed between the UK and all foreign countries at current rates of exchange as follows:

	United Kingdom		All foreign countries		Group	
Revenue is based on location of sale	2010 £m	2009 £m	2010 £m	2009 £m	2010 £m	2009 £m
External revenue	103	83	14,780	14,125	14,883	14,208

	United Kingdom		All foreign countries		Group	
	2010 £m	2009 £m	2010 £m	2009 £m	2010 £m	2009 £m
Intangible assets	110	65	12,348	12,167	12,458	12,232
Property, plant and equipment	159	130	2,958	2,880	3,117	3,010
Investments in associates and joint ventures			2,666	2,521	2,666	2,521

Included in the external revenue from foreign countries is £1,696 million (2009: £1,529 million) attributable to Brazil, being the only subsidiary contributing more than 10 per cent of the Group's external revenue in 2010 and 2009. The main acquisitions comprising the goodwill balance of £11,656 million (2009: £11,331 million) in intangible assets is provided in note 9. Included in investments in associates and joint ventures are amounts of £1,872 million (2009: £1,805 million) attributable to the investment in Reynolds American and £747 million (2009: £670 million) attributable to the investment in ITC. Further information can be found in note 11.

2 Segmental analyses continued

Segmental analysis of revenue and profit for 2010 for the regional structure change that will be applicable from 2011
Due to the decision to reduce the management structure from five regions to four regions from 1 January 2011, markets which currently comprise the Eastern Europe region will be merged into the Africa and Middle East region and the Western Europe region. Russia, Ukraine, Moldova, Belarus, Caucasus and Central Asia will form part of the new Eastern Europe, Middle East and Africa region (EEMEA) while Romania, Bulgaria, Serbia, Montenegro, Albania and Kosovo will become part of the Western Europe region. The following analysis of revenue and adjusted profit from operations is being provided as additional information and will be the comparative information used by the Management Board in 2011 to evaluate segment performance and allocate resources.

	2010 Revenue Current rates £m
Asia-Pacific	3,759
Americas	3,498
Western Europe	3,695
Eastern Europe, Middle East and Africa	3,931
Revenue	**14,883**

			2010
	Adjusted* segment profit Current rates £m	Adjusting items £m	Segment result Current rates £m
Asia-Pacific	1,332	(56)	1,276
Americas	1,382	(36)	1,346
Western Europe	1,103	(236)	867
Eastern Europe, Middle East and Africa	1,167	(338)	829
Profit from operations	4,984	(666)	4,318
Net finance costs			(480)
Asia-Pacific	208	(9)	199
Americas	412	(63)	349
Western Europe			
Eastern Europe, Middle East and Africa	2		2
Share of post-tax results of associates and joint ventures	622	(72)	550
Profit before taxation			4,388

* The adjustments to profit from operations and the Group's share of the post-tax results of associates and joint ventures are explained in notes 3(e) to 3(h) and in note 5, respectively.

Notes on the accounts (continued)

3 Profit from operations

(a) Employee benefit costs

	2010 £m	2009 £m
Wages and salaries	**2,099**	1,880
Social security costs	**245**	225
Other pension and retirement benefit costs (note 12)	**119**	137
Share-based payments (note 27)	**87**	75
	2,550	2,317

(b) Depreciation, amortisation and impairment costs

		2010 £m	2009 £m
Intangibles	– amortisation of trademarks (note 3(f))	**62**	58
	– amortisation of other intangibles	**66**	67
	– impairment	**300**	53
Property, plant and equipment	– depreciation	**376**	379
	– impairment	**93**	54
		897	611

Impairment of goodwill and trademarks is as explained in note 3(g). Impairment in respect of other intangibles and property, plant and equipment are shown as part of restructuring costs (see note 3(e)).

(c) Other operating income

This represents income arising from the Group's activities which falls outside the definition of revenue and includes gains on disposal of trademarks as well as property disposals, service fees and other shared costs charged to third parties, manufacturing fees and trademark income.

3 Profit from operations continued

(d) Other operating expenses include:

	2010 £m	2009 £m
Research and development expenses (excluding employee benefit costs and depreciation)	55	51
Exchange differences	62	17
Rent of plant and equipment (operating leases)		
– minimum lease payments	39	37
– contingent rents		2
– sublease payments	1	3
Rent of property (operating leases)		
– minimum lease payments	84	83
– contingent rents	1	1
– sublease payments	2	3
Fees payable for audit services pursuant to legislation:		
– fees payable to PricewaterhouseCoopers LLP for Parent Company and Group audit	1.8	1.7
– fees payable to other PricewaterhouseCoopers firms and associates for local statutory and Group reporting audits	7.9	8.6
Audit fees payable to PricewaterhouseCoopers firms and associates	9.7	10.3
Audit fees payable to other firms	0.4	0.5
Total audit fees payable	10.1	10.8
Fees payable to PricewaterhouseCoopers firms and associates for other services:		
– other services pursuant to statutory legislation	0.2	0.2
– tax advisory services	5.6	4.3
– tax compliance	1.0	1.2
– services relating to information technology	2.1	1.2
– other non-audit services	0.5	0.9
	9.4	7.8

The total fees payable to PricewaterhouseCoopers firms and associates included above are £19.1 million (2009: £18.1 million).

Total research and development costs including employee benefit costs and depreciation were £117 million (2009: £112 million).

As a result of restrictions on accessing foreign exchange at the official exchange rate in Uzbekistan, the Group has revalued monetary items, mostly comprising foreign currency payables, in its subsidiary in Uzbekistan at a more conservative rate. This rate represents the rate at which management expects to settle these items and has resulted in the recognition of net exchange losses of £38 million. These are included in exchange differences of £62 million within other operating expenses in 2010.

(e) Restructuring and integration costs

Restructuring costs reflect the costs incurred as a result of initiatives to improve the effectiveness and the efficiency of the Group as a globally integrated enterprise. These initiatives include a review of the Group's manufacturing operations, overheads and indirect costs, organisational structure and systems and software used. The costs of these initiatives together with the costs of integrating acquired businesses into existing operations, are included in profit from operations under the following headings:

	2010 £m	2009 £m
Employee benefit costs	163	143
Depreciation, amortisation and impairment costs	100	107
Other operating expenses	68	61
Other operating income	(20)	(7)
	311	304

Notes on the accounts (continued)

3 Profit from operations continued

Restructuring and integration costs in 2010 principally relate to: the continuation of factory closure and downsizing activities in Denmark and Australia respectively; the closure of the Jawornik factory in Poland, the Tire factory in Turkey and the Lecce factory in Italy. The costs also cover a voluntary separation scheme and closure of the printing unit in Argentina and the continued integration of Bentoel into existing operations; as well as other restructuring initiatives directly related to improving the efficiency and effectiveness of the Group as a globally integrated enterprise. These include the combining of the Group's businesses in Belgium, Luxembourg and the Netherlands and charges for bringing employee benefit costs in the Group's subsidiary in Canada in line with the Group's global practices. In addition, the Group has recognised impairment charges as a result of the continued review of its software assets in light of the development of global software solutions.

Restructuring and integration costs in 2010 also include a payment of US$21 million to Reynolds American relating to the early termination and settlement of all disputes at issue in respect of the Contract Manufacturing Agreement dated 30 July 2004, as explained in note 29.

Restructuring and integration costs in 2009 principally relate to: costs in respect of the planned closure of the Soeborg factory in Denmark; the planned downsizing of the manufacturing plant in Australia; the continued integration of ST, Tekel and Bentoel with existing operations; as well as other restructuring initiatives directly related to improving the efficiency and effectiveness of the Group as a globally integrated enterprise. The costs for these other initiatives include redundancies, principally in respect of restructuring activities in the Group's subsidiary in Canada, and impairment charges for certain software assets where the development of global software solutions has resulted in these assets having minimal or limited future economic benefits.

Other operating income in 2010 includes gains from sale of surplus land and buildings in Turkey and Croatia as well as the release of deferred income from a disposal in 2007. In 2009, other operating income also includes gains on property disposals and the release of deferred income from a disposal in 2007.

(f) Amortisation of trademarks
The acquisitions of Bentoel, Tekel and ST resulted in the capitalisation of trademarks which are amortised over their expected useful lives, which do not exceed 20 years. The amortisation charge of £62 million (2009: £58 million) is included in depreciation, amortisation and impairment costs in profit from operations.

(g) Impairment of goodwill and trademarks
Goodwill and trademarks recognised as a result of the Tekel acquisition in 2008 have been impaired by £249 million and £44 million respectively. Although cost saving initiatives in the acquisition plan have been delivered successfully, the impairment charge arises from intense pricing competition in 2010 following unforeseen and significant excise increases in Turkey in 2009 and further increases effective from January 2010 which resulted in the growth of illicit trade and a loss of volumes and market share. The basis for determining the deterioration in the recoverable amounts of the trademarks and goodwill is explained in note 9.

(h) Gains on disposal of businesses and trademarks
The acquisition of the cigarette and snus businesses of Skandinavisk Tobakskompagni (ST) in 2008 was subject to regulatory approval which was received on the condition that the Group divest a small number of local trademarks, primarily in Norway. The disposal of the trademarks was dealt with in two packages, with the first package sold and completed in February 2009. In March 2009, contracts were exchanged in respect of the second package with completion in May 2009. The total proceeds from the two packages resulted in a gain of £2 million which is included in other operating income in profit from operations for the year ended 31 December 2009.

4 Net finance costs

	2010 £m	2010 £m	2009 £m	2009 £m
Finance costs				
– interest payable	583		602	
– fair value changes	209		4	
– exchange differences	(285)		(25)	
		507		581
Finance income				
– interest and dividend income	(60)		(85)	
– exchange differences	33		8	
		(27)		(77)
Net finance costs		480		504
Net finance costs comprise:				
Interest payable				
– bank borrowings	81		80	
– finance leases	2		2	
– facility fees	8		4	
– other	492		516	
		583		602
Interest receivable	(58)		(83)	
Dividend income	(2)		(2)	
		(60)		(85)
Fair value changes				
– cash flow hedges transferred from equity	16		86	
– fair value changes on hedged items	78		(7)	
– fair value hedges	(166)		(65)	
– ineffective portion of fair value hedges	(21)		(13)	
– instruments held-for-trading*	302		3	
	209		4	
Exchange differences	(252)		(17)	
		(43)		(13)
		480		504

* IFRS requires derivatives which do not meet the tests for hedge accounting under IAS 39 to be classified as instruments held-for-trading with fair value changes included in the income statement. These derivatives principally consist of other derivatives shown in note 16(d) and forward foreign currency contracts which have not been designated as hedges due to their fair value changes offsetting with other components of net finance costs.

Other interest payable includes interest on the bonds and notes detailed in note 21. Facility fees relate principally to the Group's central undrawn banking facility of £2 billion (a £1.75 billion facility up to December 2010), as well as the Group's €450 million term loan facility (a €700 million facility up to December 2010). Both facilities were renegotiated and agreed during December 2010.

Included within interest receivable is £1 million (2009: £3 million) in respect of available-for-sale investments. Included within dividend income is £2 million (2009: £2 million) in respect of available-for-sale investments.

Included within exchange differences is a loss of £14 million (2009: £25 million loss) in respect of items subject to fair value hedges.

Notes on the accounts (continued)

5 Associates and joint ventures

	2010		2009	
	Total £m	Group's share £m	Total £m	Group's share £m
Gross turnover (including duty, excise and other taxes)	**12,834**	**4,924**	11,506	4,477
Duty, excise and other taxes	**(4,205)**	**(1,620)**	(3,687)	(1,431)
Revenue	**8,629**	**3,304**	7,819	3,046
Profit from operations	**2,473**	**938**	2,183	843
Net finance costs	**(152)**	**(63)**	(159)	(66)
Profit on ordinary activities before taxation	**2,321**	**875**	2,024	777
Taxation on ordinary activities	**(846)**	**(322)**	(759)	(291)
Profit on ordinary activities after taxation	**1,475**	**553**	1,265	486
Attributable to:				
Owners of parent company		**550**		483
Non-controlling assets		**3**		3
		553		486
Analysed as:				
– adjusted share of post-tax results of associates and joint ventures		**622**		541
– trademark amortisation and impairments	**(3)**	**(1)**	(154)	(65)
– health plan credit			38	16
– Canadian settlements	**(140)**	**(59)**		
– dilution in shareholding	**(30)**	**(9)**		
– restructuring costs	**(7)**	**(3)**	(22)	(9)
		550		483
Dividends				
– listed investments		**460**		328
– unlisted investments		**6**		3
		466		331

The share of post-tax results of associates and joint ventures is after the following adjusting items which are excluded from the calculation of adjusted earnings per share as set out in note 7.

In the year ended 31 December 2010, Reynolds American recognised a trademark impairment charge of US$6 million as well as trademark amortisation of US$4 million. The Group's share of these charges amounted to £1 million (net of tax).

In the year ended 31 December 2010, a subsidiary of Reynolds American, R.J. Reynolds Tobacco Company Inc. (RJRTC), entered into a comprehensive settlement agreement with the Canadian federal, provincial and territorial governments to resolve all the governments' civil claims related to smuggling in Canada during the 1980s and 1990s. As part of the civil settlement, RJRTC agreed to pay the governments CA$325 million. In a separate matter, a subsidiary of R.J. Reynolds Tobacco Holdings Inc., Northern Brands International Inc., entered into a plea agreement with the Ministry of the Attorney General of Ontario. As a result of its plea to one count of conspiracy to aid others in the sale and possession of contraband cigarettes in the early 1990s, Northern Brands paid a fine of CA$75 million. The Group's share of these charges amounted to £59 million (net of tax).

During the year, the Group's interest in ITC decreased from 31.92 per cent to 31.43 per cent as a result of ITC issuing ordinary shares under the Company's Employee Stock Option Scheme. This dilution in the Group's share of ITC results in a charge of £9 million which, under IAS 28 Revised (Investments in Associates), is treated as a partial disposal and included in the income statement.

Reynolds American also recognised restructuring charges in the year ended 31 December 2010 from the closure of one factory in August 2010 and the planned closure of another in mid 2011. As a result of these actions, Reynolds American has recorded charges mostly relating to asset impairment and to a lesser extent, severance costs. The Group's share of these charges amounted to £6 million (net of tax).

5 Associates and joint ventures continued

In the year ended 31 December 2010, RJRTC received a payment of US$21 million as a result of the agreement to terminate early the Contract Manufacturing Agreement dated 30 July 2004 between RJRTC and BATUS Japan Inc., a wholly owned Group subsidiary, and settle all disputes at issue between the parties as explained in note 29. The Group's share of this receipt amounted to £3 million (net of tax) and is treated as an adjusting item. The receipt (net of tax) is included as part of restructuring costs in the table above.

In the year ended 31 December 2009, Reynolds American recognised a trademark impairment charge of US$394 million, triggered by the increase in federal excise taxes on tobacco products and changes in pricing. It also recognised trademark amortisation of US$5 million. The Group's share of these charges amounted to £65 million (net of tax).

During 2009, Reynolds American reviewed its post-retirement medical plans resulting in a past service credit which is amortised under US GAAP. However, under IFRS, it must be recognised in full in the income statement in 2009. The Group's share of this credit amounted to £16 million (net of tax).

Reynolds American also recognised a charge of US$56 million in 2009 in connection with severance and related costs of around 400 employees in order to better align staffing levels with business requirements and enable Reynolds American's manufacturing operations to phase in new productivity programmes. The Group's share of this charge amounted to £9 million (net of tax).

6 Taxation on ordinary activities

(a) Summary of tax on ordinary activities

	2010 £m	2009 £m
UK corporation tax (credit)/charge	**(16)**	16
Comprising:		
– current year tax expense	**16**	594
– adjustments in respect of prior periods	**(16)**	16
– double taxation relief	**(16)**	(594)
Overseas tax	**1,294**	1,147
Comprising:		
– current year tax expense	**1,270**	1,104
– adjustments in respect of prior periods	**24**	43
Total current tax	**1,278**	1,163
Deferred tax	**(30)**	(39)
Comprising:		
– deferred tax relating to origination and reversal of temporary differences	**(30)**	(42)
– deferred tax relating to changes in tax rates		3
	1,248	1,124

(b) Franked Investment Income Group Litigation Order

British American Tobacco is the principal test claimant in an action in the United Kingdom against HM Revenue and Customs in the Franked Investment Income Group Litigation Order (FII GLO). There are 26 corporate groups in the FII GLO. The case concerns the treatment for UK corporate tax purposes of profits earned overseas and distributed to the UK. The claim was filed in 2003 and the case was heard in the European Court of Justice (ECJ) in 2005 and a decision of the ECJ received in December 2006. In July 2008, the case reverted to a trial in the UK High Court for the UK Court to determine how the principles of the ECJ decision should be applied in a UK context.

The High Court judgment in November 2008 concluded, amongst many other things, that dividends received from EU subsidiaries should be, and should have been, exempt from UK taxation. It also concluded that certain dividends received before 5 April 1999 from the EU and, in some limited circumstances after 1993 from outside the EU, should have been treated as franked investment income with the consequence that advance corporation tax need not have been paid. Claims for the repayment of UK tax incurred where the dividends were from the EU can be made back to 1973. The tentative conclusion reached by the High Court would, if upheld, produce an estimated receivable of about £1.2 billion for British American Tobacco.

Notes on the accounts (continued)

6 Taxation on ordinary activities continued

The case was heard by the Court of Appeal in October 2009 and the judgment handed down on 23 February 2010. The Court of Appeal has determined that various questions should be referred back to the ECJ for further clarification. In addition, the Court determined that the claim should be restricted to six years and not cover claims dating back to 1973. This time restriction would, if upheld, reduce the value of the claim to between zero and £10 million. Based on advice received, the Company believes it has realistic prospects of success on further appeal. The Company sought leave to appeal from the Supreme Court in the UK and the Supreme Court has agreed to hear the appeal on time limits although no date has yet been set for the hearing. Several questions are to be referred back to the ECJ for further clarification.

No potential receipt has been recognised in the current year or the prior year, in the results of the Group, due to the uncertainty of the amounts and eventual outcome.

(c) Factors affecting the tax charge

The taxation charge differs from the standard 28 per cent rate of corporation tax in the UK. The major causes of this difference are listed below:

	2010		2009	
	£m	%	£m	%
Profit before tax	**4,388**		4,080	
Less: share of post-tax results of associates and joint ventures	**(550)**		(483)	
	3,838		3,597	
Tax at 28% on the above	**1,075**	**28.0**	1,007	28.0
Factors affecting the tax rate:				
Tax at standard rates other than UK corporation tax rate	**(4)**	**(0.1)**	(47)	(1.3)
Other national tax charges	**25**	**0.7**	26	0.7
State and local taxes	**52**	**1.4**	52	1.4
Permanent differences	**(10)**	**(0.3)**	(22)	(0.6)
Overseas withholding taxes	**123**	**3.2**	91	2.5
Double taxation relief on UK profits	**(16)**	**(0.4)**	(10)	(0.3)
Unutilised tax losses	**(2)**	**(0.1)**	15	0.4
Adjustments in respect of previous periods	**8**	**0.2**	59	1.6
Net deferred tax credits at other tax rates	**(3)**	**(0.1)**	(50)	(1.4)
Deferred tax attributable to a increase in the rate of corporate income tax			3	0.1
	1,248	**32.5**	1,124	31.1

Given the deterioration in the results of the Group's operations in Turkey as explained in note 3(g), the Group has also written off deferred tax assets of £35 million in respect of unutilised losses in Turkey in 2010. This has been treated as an adjusting item in the adjusted earnings per share calculation as set out in note 7.

The tax charge for 2009 includes a one-off tax charge of £24 million following an adverse decision by the Australian Courts in December 2009. This was in respect of a tax case pursued by the Australian Tax Office concerning the utilisation of capital losses. During 2010, this adverse decision was upheld by the Full Federal Court of Australia. The Group has now sought leave to appeal to the Australian High Court.

(d) Tax on items recognised directly in other comprehensive income

	2010 £m	2009 £m
Current tax	**(23)**	(43)
Deferred tax	**24**	(28)
Credited/(charged) to other comprehensive income	**1**	(71)

The tax relating to each component of other comprehensive income is disclosed in note 20.

7 Earnings per share

Basic earnings per share are based on profit for the year attributable to ordinary shareholders of £2,879 million (2009: £2,713 million) and 1,983 million (2009: 1,980 million) ordinary shares of 25p each, being the weighted average number of shares in issue during the year (excluding shares held as treasury shares).

For the calculation of diluted earnings per share, the weighted average number of shares in issue is increased to 1,994 million (2009: 1,991 million) to reflect the potential dilutive effect of employee share schemes.

	2010			2009		
	Earnings £m	Weighted average number of shares m	Earnings per share pence	Earnings £m	Weighted average number of shares m	Earnings per share pence
Basic earnings per share	**2,879**	**1,983**	**145.2**	2,713	1,980	137.0
Share options		**11**	**(0.8)**		11	(0.7)
Diluted earnings per share	**2,879**	**1,994**	**144.4**	2,713	1,991	136.3

Earnings have been affected by a number of adjusting items, which are described in notes 3, 5 and 6. To illustrate the impact of these items, an adjusted earnings per share calculation is shown below.

Adjusted earnings per share calculation

		Diluted				Basic			
		2010		2009		2010		2009	
	Notes	Earnings £m	Earnings per share pence	Earnings £m	Earnings per share pence	Earnings £m	Earnings per share pence	Earnings £m	Earnings per share pence
Unadjusted earnings per share		**2,879**	**144.4**	2,713	136.3	**2,879**	**145.2**	2,713	137.0
Effect of restructuring and integration costs	3e	**311**	**15.6**	304	15.3	**311**	**15.7**	304	15.4
Tax and non-controlling interests on restructuring and integration costs		**(75)**	**(3.8)**	(71)	(3.6)	**(75)**	**(3.8)**	(71)	(3.6)
Effect of impairment of goodwill and trademarks	3g	**293**	**14.7**			**293**	**14.8**		
Tax on impairment of goodwill and trademarks		**(58)**	**(2.9)**			**(58)**	**(2.9)**		
Effect of deferred tax asset written off	6c	**35**	**1.8**			**35**	**1.8**		
Amortisation of trademarks	3f	**62**	**3.1**	58	2.9	**62**	**3.1**	58	2.9
Tax on amortisation of trademarks		**(15)**	**(0.8)**	(15)	(0.8)	**(15)**	**(0.8)**	(15)	(0.8)
Effect of disposal of businesses and trademarks	3h			(2)	(0.1)			(2)	(0.1)
Tax relating to disposal of businesses and trademarks				1	0.1			1	0.1
Effect of associates' adjusting items	5	**72**	**3.6**	58	2.9	**72**	**3.6**	58	2.9
Adjusted earnings per share		**3,504**	**175.7**	3,046	153.0	**3,504**	**176.7**	3,046	153.8

Notes on the accounts (continued)

7 Earnings per share continued

Headline earnings per share as required by the JSE Limited

The presentation of headline earnings per share, as an alternative measure of earnings per share, is mandated under the JSE Listing Requirements. It is calculated in accordance with Circular 3/2009 'Headline Earnings', as issued by the South African Institute of Chartered Accountants. Headline earnings per share are calculated as shown below:

	Diluted				Basic			
	2010		2009		2010		2009	
	Earnings £m	Earnings per share pence	Earnings £m	Earnings per share pence	Earnings £m	Earnings per share pence	Earnings £m	Earnings per share pence
Unadjusted earnings per share	2,879	144.4	2,713	136.3	2,879	145.2	2,713	137.0
Effect of impairment of intangibles and property, plant and equipment	393	19.7	107	5.4	393	19.8	107	5.5
Tax and non-controlling interests on impairment of intangibles and property, plant and equipment	(81)	(4.1)	(21)	(1.1)	(81)	(4.1)	(21)	(1.1)
Effect of gains on disposal of property, plant and equipment			(4)	(0.2)			(4)	(0.2)
Effect of gains on disposal of non-current assets held-for-sale	(16)	(0.8)			(16)	(0.8)		
Tax and non-controlling interests on disposal of non-current assets held-for-sale	3	0.1			3	0.1		
Effect of disposal of businesses and trademarks	(5)	(0.3)	(5)	(0.3)	(5)	(0.3)	(5)	(0.3)
Tax and non-controlling interests on disposal of businesses and trademarks	2	0.1	1	0.1	2	0.1	1	0.1
Effect of gains reclassified from the available-for-sale reserve			(3)	(0.2)			(3)	(0.2)
Share of associates' trademark and other asset impairments net of tax	7	0.4	65	3.3	7	0.4	65	3.3
Dilution in shareholding in associate	9	0.5			9	0.5		
Headline earnings per share	3,191	160.0	2,853	143.3	3,191	160.9	2,853	144.1

8 Dividends and other appropriations

	2010		2009	
	Pence per share	£m	Pence per share	£m
Ordinary shares				
Interim				
2010 paid 29 September 2010	33.2	662		
2009 paid 29 September 2009			27.9	557
Final				
2009 paid 6 May 2010	71.6	1,431		
2008 paid 6 May 2009			61.6	1,241
	104.8	2,093	89.5	1,798

The Directors have recommended to shareholders a final dividend of 81.0 pence per share for the year ended 31 December 2010. If approved, this dividend will be paid to shareholders on 5 May 2011. This dividend is subject to approval by shareholders at the Annual General Meeting and therefore, in accordance with IAS 10, it has not been included as a liability in these Financial Statements. The total estimated dividend to be paid is £1,607 million which takes the total dividends declared in respect of 2010 to £2,269 million (2009: £1,988 million) representing 114.2 pence per share (2009: 99.5 pence per share).

9 Intangible assets

	Goodwill £m	Computer software £m	Trademarks and licences £m	Assets in the course of development £m	Total £m
1 January 2010					
Cost	**11,331**	**502**	**806**	**63**	**12,702**
Accumulated amortisation and impairment		**(361)**	**(109)**		**(470)**
Net book value at 1 January 2010	**11,331**	**141**	**697**	**63**	**12,232**
Differences on exchange	**574**	**1**	**(9)**	**1**	**567**
Additions					
– internal development		**4**		**60**	**64**
– separately acquired		**12**	**5**	**7**	**24**
Reallocations		**48**		**(48)**	
Amortisation charge		**(64)**	**(64)**		**(128)**
Impairment	**(249)**	**(7)**	**(44)**		**(300)**
Disposals		**(1)**			**(1)**
31 December 2010					
Cost	**11,656**	**551**	**802**	**83**	**13,092**
Accumulated amortisation and impairment		**(417)**	**(217)**		**(634)**
Net book value at 31 December 2010	**11,656**	**134**	**585**	**83**	**12,458**
1 January 2009					
Cost	11,391	388	758	85	12,622
Accumulated amortisation and impairment		(251)	(53)		(304)
Net book value at 1 January 2009	11,391	137	705	85	12,318
Differences on exchange	(260)	(11)	(49)	6	(314)
Additions					
– internal development		30		10	40
– acquisitions of subsidiaries and non-controlling interests	200	1	95		296
– separately acquired		24	7	43	74
Reallocations		81		(81)	
Amortisation charge		(65)	(61)		(126)
Impairment		(54)			(54)
Disposals		(2)			(2)
31 December 2009					
Cost	11,331	502	806	63	12,702
Accumulated amortisation and impairment		(361)	(109)		(470)
Net book value at 31 December 2009	11,331	141	697	63	12,232

Included in computer software and assets in the course of development are internally developed assets with a carrying value of £150 million (2009: £138 million). The costs of internally developed assets include capitalised expenses of employees working full time on software development projects, third party consultants as well as software licence fees from third party suppliers.

Acquisitions of subsidiaries and non-controlling interests in 2009 relate to the acquisition of Bentoel as explained in note 26.

Included in the net book value of trademarks and licences are trademarks relating to the acquisition of ST £412 million (2009: £469 million), Tekel £61 million (2009: £113 million) and Bentoel £94 million (2009: £99 million).

As a result of a loss of volumes in 2010, the Tekel trademarks have been impaired by £44 million as explained in note 3(g). The recoverable amount of the Tekel trademarks has been determined on a value-in-use basis over their remaining useful economic lives applying the same assumptions used to determine the recoverable amount of the Group's Turkey cash-generating unit as described below.

The impairment charges for computer software in 2010 and 2009 are explained in note 3(e).

Notes on the accounts (continued)

9 Intangible assets continued

Impairment testing for intangible assets with indefinite lives including goodwill

Goodwill of £11,656 million (2009: £11,331 million) included in intangible assets in the balance sheet is mainly the result of the following acquisitions: Rothmans Group £5,176 million (2009: £4,833 million); Imperial Tobacco Canada £2,576 million (2009: £2,370 million); ETI (Italy) £1,412 million (2009: £1,463 million); ST (principally Scandinavia) £1,062 million (2009: £1,103 million); Tekel (Turkey) £333 million (2009: £579 million) and Bentoel (Indonesia) £220 million (2009: £205 million). The principal allocations of goodwill in the Rothmans' acquisition are to the cash-generating units of Eastern and Western Europe, and South Africa, with the remainder mainly relating to operations in the domestic and export markets in the United Kingdom and operations in Asia-Pacific. The goodwill on the ST transaction has been allocated between the cash-generating units of ST and Western Europe.

In 2010 and 2009, goodwill has been allocated for impairment testing purposes to 16 individual cash-generating units – four in Western Europe, one in Eastern Europe, two in Africa and Middle East, five in Asia-Pacific and four in the Americas.

The carrying amounts of goodwill allocated to the cash-generating units of Canada £2,576 million (2009: £2,370 million), Italy £1,419 million (2009: £1,471 million), Western Europe (includes Rothmans and other acquisitions) £1,214 million (2009: £1,208 million), Eastern Europe (includes Rothmans and other acquisitions) £1,070 million (2009: £1,062 million), ST (principally Scandinavia) £954 million (2009: £991 million), South Africa £1,069 million (2009: £932 million), Australia (includes Rothmans and other acquisitions) £877 million (2009: £746 million), Singapore £532 million (2009: £471 million), Malaysia £488 million (2009: £426 million) and Turkey £333 million (2009: £579 million) are considered significant in comparison with the total carrying amount of goodwill.

The recoverable amount of all cash-generating units has been determined on a value-in-use basis. The key assumptions for the recoverable amount of all units are the long-term growth rate and the discount rate. The long-term growth rate used is purely for the impairment testing of goodwill under IAS 36 (Impairment of Assets) and does not reflect long-term planning assumptions used by the Group for investment proposals or for any other assessments. The discount rate is based on the Group's weighted average cost of capital, taking into account the cost of capital and borrowings, to which specific market-related premium adjustments are made. These adjustments are derived from external sources and are based on the spread between bonds (or credit default swaps or similar indicators) issued by the US or comparable governments and by the local government, adjusted for the Group's own credit market risk. For ease of use and consistency in application, these results are periodically calibrated into bands based on internationally recognised credit ratings. These assumptions have been applied to the individual cash flows of each unit as compiled by local management in the different markets.

The valuations use cash flows based on detailed financial budgets prepared by management covering a one year period, with growth in year 2 of 6 per cent. Cash flows for the years 3 to 10 are extrapolated from year 2 cash flows at 5 per cent per annum, including 2 per cent inflation, whereafter a total growth rate of 2 per cent per annum has been assumed. The extrapolated growth rates are considered conservative given the Group's history of growth, its well balanced portfolio of brands and the industry in which it operates. The long-term real growth does not exceed the expected long-term average growth rate for the combined markets in which the cash-generating units operate. In some instances, such as recent acquisitions or start-up ventures, the valuation is expanded to reflect the medium term plan of management, spanning five years or beyond. The recoverable amount of the Turkey cash-generating unit has been determined on a value-in-use basis using a 10 year cash flow forecast with cash flows after year 10 extrapolated as described above. A forecast period of 10 years is considered appropriate to take account of the assumptions of volume stabilisation in Turkey in the medium to longer term and the time period to improve the contribution of higher margin brands. In addition the forecast assumes no further unforeseen significant increases in excise and the compound annual growth over the 10 year period is 3.2 per cent. As explained in note 3(g), the carrying value of goodwill allocated to the Group's cash-generating unit of Turkey has been impaired by £249 million in 2010.

Pre-tax discount rates of between 7.8 per cent and 18.7 per cent (2009: 7.9 per cent to 18.7 per cent) were used, based on the Group's weighted average cost of capital, together with any premium applicable for economic and political risks.

The pre-tax discount rates used for the cash-generating units which are significant in comparison with the total carrying amount of goodwill are 9.7 per cent for Canada (2009: 9.7 per cent), 11.0 per cent for Italy (2009: 11.4 per cent), 9.3 per cent for Western Europe (2009: 9.3 per cent), 10.6 per cent for Eastern Europe (2009: 10.6 per cent), 8.7 per cent for ST (principally Scandinavia) (2009: 8.7 per cent), 11.5 per cent for South Africa (2009: 11.5 per cent), 9.3 per cent for Australia (2009: 9.3 per cent), 7.8 per cent for Singapore (2009: 7.9 per cent), 10.0 per cent for Malaysia (2009: 10.0 per cent) and 11.9 per cent for Turkey (2009: 13.1 per cent).

Other than the impairment charge recognised in respect of Tekel goodwill, no other goodwill impairment charges were recognised in 2010 or 2009. If discounted cash flows for the Turkey cash-generating unit should fall by 10 per cent, or the discount rate was increased at a post-tax rate of 1 per cent, there would be further impairment of £55 million and £69 million respectively. If discounted cash flows for any of the other cash-generating units should fall by 10 per cent, or the discount rate was increased at a post-tax rate of 1 per cent, there would be no impairment.

10 Property, plant and equipment

	Freehold property £m	Leasehold property £m	Plant and equipment £m	Assets in the course of construction £m	Total £m
1 January 2010					
Cost	1,101	237	4,466	336	6,140
Accumulated depreciation and impairment	(421)	(95)	(2,614)		(3,130)
Net book value at 1 January 2010	680	142	1,852	336	3,010
Differences on exchange	34	3	80	21	138
Additions					
– separately acquired	20	6	137	354	517
Reallocations	30	5	307	(342)	
Depreciation	(30)	(7)	(344)		(381)
Impairment	(30)		(64)		(94)
Disposals	(3)	(8)	(37)		(48)
Net reclassifications as held-for-sale	(24)		(1)		(25)
31 December 2010					
Cost	1,144	250	4,820	369	6,583
Accumulated depreciation and impairment	(467)	(109)	(2,890)		(3,466)
Net book value at 31 December 2010	677	141	1,930	369	3,117
1 January 2009					
Cost	1,014	257	4,565	316	6,152
Accumulated depreciation and impairment	(351)	(95)	(2,630)		(3,076)
Net book value at 1 January 2009	663	162	1,935	316	3,076
Differences on exchange	(17)	(12)	(107)	(11)	(147)
Additions					
– separately acquired	23	4	139	305	471
– acquisitions of subsidiaries	20		47	11	78
Reallocations	33		247	(280)	
Depreciation	(26)	(11)	(351)		(388)
Impairment	(16)		(36)		(52)
Disposals			(21)	(5)	(26)
Net reclassifications as held-for-sale		(1)	(1)		(2)
31 December 2009					
Cost	1,101	237	4,466	336	6,140
Accumulated depreciation and impairment	(421)	(95)	(2,614)		(3,130)
Net book value at 31 December 2009	680	142	1,852	336	3,010
Assets held under finance leases					
31 December 2010					
Cost		3	72		75
Accumulated depreciation and impairment		(2)	(56)		(58)
Net book value at 31 December 2010		1	16		17
31 December 2009					
Cost		3	117		120
Accumulated depreciation and impairment		(2)	(87)		(89)
Net book value at 31 December 2009		1	30		31

Notes on the accounts (continued)

10 Property, plant and equipment continued

The Group's finance lease arrangements relate principally to the lease of vending machines by the Group's Japanese subsidiary. Assets held under finance leases are secured under finance lease obligations included in note 21.

	2010 £m	2009 £m
Cost of freehold land within freehold property on which no depreciation is provided	**98**	92
Leasehold property comprises		
– net book value of long leasehold	**106**	102
– net book value of short leasehold	**35**	40
	141	142
Contracts placed for future expenditure	**7**	11

Bank borrowings are secured by property, plant and equipment to the value of £24 million (2009: £14 million).

11 Investments in associates and joint ventures

	2010 £m	2009 £m
1 January	**2,521**	2,552
Differences on exchange	**105**	(258)
Differences on exchange reclassified and reported in share of profit after taxation	**(2)**	
Share of profit after taxation (note 5)	**550**	483
Dividends (note 5)	**(466)**	(331)
Actuarial (losses)/gains relating to pensions and other post-retirement benefits (note 20)	**(54)**	61
Other equity movements	**12**	14
31 December	**2,666**	2,521
Non-current assets	**4,278**	3,984
Current assets	**1,774**	1,884
Non-current liabilities	**(1,801)**	(1,980)
Current liabilities	**(1,585)**	(1,367)
	2,666	2,521
Reynolds American Inc. (Group's share of market value £5,105 million (2009: £4,019 million))	**1,872**	1,805
ITC Ltd. (Group's share of market value £6,020 million (2009: £4,036 million))	**747**	670
Other listed associates (Group's share of market value £44 million (2009: £35 million))	**13**	12
Unlisted	**34**	34
	2,666	2,521

The Group's share of non-current assets above include £1,508 million (2009: £1,463 million) of goodwill and £500 million (2009: £485 million) of trademarks arising from the Reynolds American transaction in 2004. In addition, the non-current assets above includes £664 million (2009: £653 million) of goodwill and £310 million (2009: £302 million) of trademarks arising from the acquisition of Conwood by Reynolds American in 2006.

Details of the Group's contingent liabilities are set out in note 30. In addition to US litigation involving Group companies, which is covered by the R.J. Reynolds Tobacco Company (RJRT) indemnity referred to in note 30, Reynolds American Inc. (RAI) group companies are named in litigation which does not involve Group companies. While it is impossible to be certain of the outcome of any particular case or of the amount of any possible adverse verdict, it is not impossible that the results of operations or cash flows of RAI, in particular quarterly or annual periods, could be materially affected by this and by the final outcome of any particular litigation. However, having regard to the contingent liability disclosures on litigation made by RAI in its public financial reports, the Directors are satisfied with the carrying value included above for RAI.

The Group's share of the RAI results for the year to 31 December 2010 includes £50 million (2009: £33 million) in respect of external legal fees and other external product liability defence costs.

Additional information on associates as well as principal subsidiary undertakings is provided in the Principal subsidiary undertakings and Principal associate undertakings sections to the Annual Report.

12 Retirement benefit schemes

The Group's subsidiary undertakings operate around 180 retirement benefit arrangements worldwide. These arrangements have been developed in accordance with local practices in the countries concerned. The majority of scheme members belong to defined benefit schemes, most of which are funded externally and many of which are closed to new entrants. The Group also operates a number of defined contribution schemes.

The liabilities arising in the defined benefit schemes are determined in accordance with the advice of independent, professionally qualified actuaries, using the projected unit credit method. All schemes are formally valued at least every three years.

The principal pension schemes are in the UK, Germany, Canada, the Netherlands and Switzerland. Together these schemes account for 85 per cent of the total obligations of the Group's defined benefit schemes.

In addition, the Group operates significant schemes in Canada which provide employees with certain other retirement benefits such as healthcare. The liabilities in respect of these benefits are also assessed by qualified independent actuaries, applying the projected unit credit method.

The amounts recognised in the balance sheet are determined as follows:

	Pension schemes		Healthcare schemes		Total	
	2010 £m	2009 £m	2010 £m	2009 £m	2010 £m	2009 £m
Present value of funded scheme liabilities	**(5,338)**	(5,222)	**(27)**	(28)	**(5,365)**	(5,250)
Fair value of funded scheme assets	**5,114**	4,618	**20**	16	**5,134**	4,634
	(224)	(604)	**(7)**	(12)	**(231)**	(616)
Minimum funding obligations	**(29)**	(75)			**(29)**	(75)
Unrecognised funded scheme surpluses	**(51)**	(52)			**(51)**	(52)
	(304)	(731)	**(7)**	(12)	**(311)**	(743)
Present value of unfunded scheme liabilities	**(174)**	(148)	**(163)**	(134)	**(337)**	(282)
Unrecognised past service cost		1				1
	(478)	(878)	**(170)**	(146)	**(648)**	(1,024)
The above net liability is recognised in the balance sheet as follows:						
– retirement benefit scheme liabilities	**(600)**	(983)	**(170)**	(146)	**(770)**	(1,129)
– retirement benefit scheme assets	**122**	105			**122**	105
	(478)	(878)	**(170)**	(146)	**(648)**	(1,024)

The total accumulated net actuarial losses taken through other comprehensive income at 31 December 2010 were £693 million (2009: £886 million) for subsidiaries, and £350 million (2009: £296 million) net of tax for associates and joint ventures.

In Jamaica, the pension scheme holds shares in Carreras Group Ltd (a Group subsidiary) with a fair value of £6 million (2009: £3 million).

Notes on the accounts (continued)

12 Retirement benefit schemes continued

The amounts recognised in the income statement are as follows:

	Pension schemes		Healthcare schemes		Total	
	2010 £m	2009 £m	2010 £m	2009 £m	2010 £m	2009 £m
Defined benefit schemes						
– current service cost	**69**	65	**1**	3	**70**	68
– interest cost	**300**	271	**11**	9	**311**	280
– expected return on scheme assets	**(298)**	(259)	**(2)**	(1)	**(300)**	(260)
– past service cost	**4**	17			**4**	17
– settlements and curtailments	**(2)**	4	**(2)**	1	**(4)**	5
	73	98	**8**	12	**81**	110
Defined contribution schemes	**38**	27			**38**	27
Total amount recognised in the income statement (note 3(a))	**111**	125	**8**	12	**119**	137

The above charges are recognised within employee benefit costs in 2010 and 2009 in note 3(a) and include a credit of £2 million in 2010 (2009: £11 million charge) in respect of pension costs reported as part of the restructuring costs charged in arriving at profit from operations (see note 3(e)).

The movements in scheme liabilities are as follows:

	Pension schemes		Healthcare schemes		Total	
	2010 £m	2009 £m	2010 £m	2009 £m	2010 £m	2009 £m
Present value at 1 January	**5,370**	4,752	**162**	143	**5,532**	4,895
Exchange differences	**104**	(86)	**13**	6	**117**	(80)
Current service cost	**72**	68	**1**	3	**73**	71
Interest cost	**304**	277	**11**	10	**315**	287
Past service costs – vested	**4**	16			**4**	16
Contributions by scheme members	**3**	3			**3**	3
Benefits paid	**(327)**	(313)	**(9)**	(8)	**(336)**	(321)
Settlements and curtailments	**(5)**	(1)	**(2)**	1	**(7)**	
Acquisition of subsidiaries		12				12
Scheme changes		(4)				(4)
Actuarial losses/(gains)	**(13)**	646	**14**	7	**1**	653
Present value at 31 December	**5,512**	5,370	**190**	162	**5,702**	5,532
Funded schemes	**5,338**	5,222	**27**	28	**5,365**	5,250
Unfunded schemes	**174**	148	**163**	134	**337**	282
	5,512	5,370	**190**	162	**5,702**	5,532

The actuarial losses and gains in both years principally relate to changes in assumptions regarding discount rates and inflation rates, offset in 2010 by the effect of net experience gains.

12 Retirement benefit schemes continued

The movement in funded scheme assets are as follows:

	Pension schemes		Healthcare schemes		Total	
	2010 £m	2009 £m	2010 £m	2009 £m	2010 £m	2009 £m
Fair value of scheme assets at 1 January	4,618	4,169	16	13	4,634	4,182
Exchange differences	93	(94)	3	2	96	(92)
Expected return on scheme assets	302	264	2	1	304	265
Company contributions	218	214	7	6	225	220
Contributions by scheme members	5	6			5	6
Benefits paid	(316)	(298)	(8)	(7)	(324)	(305)
Actuarial gains	194	357		1	194	358
Fair value of scheme assets at 31 December	5,114	4,618	20	16	5,134	4,634

The actuarial gains and losses in both years principally relate to movements in the market value of scheme assets.

Contributions to defined benefit schemes are determined after consultation with the respective trustees and actuaries of the individual externally funded schemes and taking into account regulatory requirements.

Contributions in 2011 are expected to be £197 million for pension schemes and £2 million for healthcare schemes, compared to £218 million and £7 million respectively in 2010.

	Pension schemes		Healthcare schemes		Total	
	2010 £m	2009 £m	2010 £m	2009 £m	2010 £m	2009 £m
Actual return on scheme assets	496	621	2	2	498	623

The movements in the unrecognised funded scheme surpluses are as follows:

	Pension schemes		Healthcare schemes		Total	
	2010 £m	2009 £m	2010 £m	2009 £m	2010 £m	2009 £m
Unrecognised funded scheme surpluses at 1 January	(52)	(61)			(52)	(61)
Exchange differences	(4)	10			(4)	10
Movement in year	5	(1)			5	(1)
Unrecognised funded scheme surpluses at 31 December	(51)	(52)			(51)	(52)

The movement in minimum funding obligations are as follows:

	Pension schemes		Healthcare schemes		Total	
	2010 £m	2009 £m	2010 £m	2009 £m	2010 £m	2009 £m
Minimum funding obligations at 1 January	(75)				(75)	
Exchange differences	(7)				(7)	
Movement in year	53	(75)			53	(75)
Minimum funding obligations at 31 December	(29)	(75)			(29)	(75)

Movements in unrecognised scheme surpluses and minimum funding obligations are recognised in other comprehensive income.

Notes on the accounts (continued)

12 Retirement benefit schemes continued

The principal actuarial assumptions (weighted to reflect individual scheme differences) used in the following principal countries are as follows:

	UK %	Germany %	Canada %	Netherlands %	Switzerland %
31 December 2010					
Rate of increase in salaries	**4.9**	**2.5**	**3.5**	**3.1**	**1.5**
Rate of increase in pensions in payment	**3.4**	**1.5**	**1.3**	**1.9**	**Nil**
Rate of increase in deferred pensions	**2.9**	**Nil**	**Nil**	**1.9**	
Discount rate	**5.4**	**4.8**	**4.7**	**5.1**	**3.0**
General inflation	**3.4**	**1.5**	**2.5**	**1.9**	**0.4**

For healthcare inflation in Canada, the assumption is 9.0 per cent reducing to 5.0 per cent by 2018.

For the remaining pension schemes, typical assumptions are that real salary increases will be from 0 per cent to 4 per cent per annum and discount rates will be from 1 per cent to 8 per cent above inflation. Pension increases, where allowed for, are generally assumed to be in line with inflation.

	UK %	Germany %	Canada %	Netherlands %	Switzerland %
31 December 2009					
Rate of increase in salaries	5.0	2.5	4.0	3.1	1.6
Rate of increase in pensions in payment	3.5	1.5	Nil	1.9	Nil
Rate of increase in deferred pensions	3.5	Nil	Nil	1.9	
Discount rate	5.7	5.3	5.4	5.2	3.5
General inflation	3.5	1.5	3.0	1.9	1.0

For healthcare inflation in Canada, the assumption is 9.5 per cent reducing to 5.0 per cent by 2018.

For the remaining pension schemes, typical assumptions are that real salary increases will be from 0 per cent to 5 per cent per annum and discount rates will be from 1 per cent to 7 per cent above inflation. Pension increases, where allowed for, are generally assumed to be in line with inflation.

Discount rates are determined by reference to normal yields on high quality corporate bonds at the balance sheet date. For countries where there is not a deep market in such corporate bonds, the yield on government bonds is used.

Mortality assumptions are subject to regular review. In the UK, Canada, Germany and Switzerland the same tables were used for both years. In the UK, for post-retirement mortality assumptions the PXA92 (year of birth) table rated up two years for active and deferred members, with a 1.2 per cent underpin on future improvements and the PXA92 (year of birth) table rated up three years for current pensioners with no underpin on future improvements, all with the medium cohort effect, have been used. In Canada UP94 tables, in Germany Heubeck tables 2005G and in Switzerland EVK 2000 mortality tables have been used. In the Netherlands AG Prognosetafel 2010-2060 mortality tables have been used (2009: AG GBM/V 2005-2050 tables).

Based on the above, the weighted average life expectancy, in years, for mortality tables used to determine benefit obligations is as follows:

	UK		Germany		Canada		Netherlands		Switzerland	
	Male	Female	Male	Female	Male	Female	Male	Female	Male	Female
31 December 2010										
Member age 65 (current life expectancy)	**19.6**	**22.4**	**18.3**	**22.4**	**19.7**	**22.1**	**19.7**	**24.5**	**17.8**	**20.6**
Member age 45 (life expectancy at age 65)	**23.3**	**26.7**	**21.0**	**25.0**	**21.2**	**22.9**	**21.3**	**24.8**	**20.6**	**23.3**
31 December 2009										
Member age 65 (current life expectancy)	19.6	22.4	18.2	22.3	19.5	22.0	18.1	21.1	17.8	20.6
Member age 45 (life expectancy at age 65)	23.2	26.6	20.9	24.9	21.1	22.8	19.8	21.9	20.6	23.3

12 Retirement benefit schemes continued

The expected rates of return on scheme assets in the following principal countries are as follows:

	UK %	Germany %	Canada %	Netherlands %	Switzerland %
31 December 2010					
Equities	**7.2**	**8.0**	**9.0**	**7.6**	**7.2**
Bonds	**4.8**	**5.0**	**4.0**	**4.2**	**2.7**
Property	**7.2**	**5.5**		**6.1**	**5.3**
Other assets	**7.2**		**Nil**	**4.0**	**1.7**

For the remaining pension schemes, typical expected long-term real rates of return ranged from 1 per cent to 11 per cent.

	UK %	Germany %	Canada %	Netherlands %	Switzerland %
31 December 2009					
Equities	7.5	8.0	9.0	7.7	7.2
Bonds	5.1	5.0	4.5	4.1	3.0
Property	7.5	5.5		6.6	4.5
Other assets	7.5		Nil	3.8	5.5

For the remaining pension schemes, typical expected long-term real rates of return ranged from 1 per cent to 10 per cent.

Expected rates of return are determined taking into account the current level of expected returns on risk-free investments, the historical level of risk premium associated with other invested assets, and the expectations for future returns on such assets.

The major categories of assets as a percentage of the total fair value of scheme assets are as follows:

	UK %	Germany %	Canada %	Netherlands %	Switzerland %	Others %	Total %
31 December 2010							
Equities	**53.9**	**33.6**	**40.7**	**29.7**	**32.0**	**23.8**	**40.6**
Bonds	**42.5**	**27.2**	**53.2**	**60.4**	**43.3**	**53.7**	**45.5**
Property	**2.0**	**39.2**		**5.3**	**17.3**	**1.7**	**8.3**
Other assets	**1.6**		**6.1**	**4.6**	**7.4**	**20.8**	**5.6**
31 December 2009							
Equities	56.8	30.0	39.2	26.2	31.4	18.5	39.5
Bonds	37.3	30.1	46.5	61.7	44.3	55.7	43.3
Property	2.1	39.9		6.2	16.9	1.6	9.0
Other assets	3.8		14.3	5.9	7.4	24.2	8.2

Other assets principally comprise hedge funds, cash and reinsurance contracts.

Notes on the accounts (continued)

12 Retirement benefit schemes continued

Valuation of post-retirement schemes involves judgments about uncertain future events. Sensitivities in respect of the key assumptions used to measure the principal pension schemes as at 31 December 2010 are set out below. These sensitivities show the hypothetical impact of a change in each of the listed assumptions in isolation, with the exception of the sensitivity to inflation which incorporates the impact of certain correlating assumptions such as salary increases. While each of these sensitivities holds all other assumptions constant, in practice such assumptions rarely change in isolation and the impacts may offset to some extent.

	1 year increase £m	1 year decrease £m	0.25 percentage point increase £m	0.25 percentage point decrease £m
Rate of mortality				
– (decrease)/increase in profit before taxation	(7)	7		
– increase/(decrease) of scheme liabilities	119	(121)		
Rate of inflation				
– (decrease)/increase in profit before taxation			(9)	8
– increase/(decrease) of scheme liabilities			116	(113)
Discount rate				
– increase/(decrease) in profit before taxation			2	(2)
– (decrease)/increase of scheme liabilities			(141)	148
Expected return on scheme assets				
– increase/(decrease) in profit before taxation			10	(10)

	2.5 percentage point increase £m	2.5 percentage point decrease £m
Market value of scheme assets		
– increase/(decrease) in profit before taxation	6	(6)
– increase/(decrease) of scheme assets	103	(103)

The effect on the profit before taxation reflects the impact on current service cost, interest cost and expected return on scheme assets where relevant, for 2011. The effect on scheme assets and liabilities is as at 31 December 2010.

A 1 percentage point change in healthcare inflation would have the following effects:

	1 percentage point increase £m	1 percentage point decrease £m
31 December 2010		
Effect on total of current service cost and interest cost	1	(1)
Effect on healthcare scheme liabilities	24	(20)

The history of the present value of the scheme liabilities, fair value of the scheme assets, the scheme net deficits and experience gains and losses are as follows:

	2010 £m	2009 £m	2008 £m	2007 £m	2006 £m
Historical information					
Scheme liabilities	5,702	5,532	4,895	4,497	4,421
Scheme assets	5,134	4,634	4,182	4,223	3,950
Scheme net deficits	(568)	(898)	(713)	(274)	(471)
Experience (gains)/losses on scheme liabilities	(191)	75	156	6	35
Experience (gains)/losses on scheme assets	(194)	(358)	857	94	(141)

Experience losses and gains on scheme liabilities are presented as part of actuarial gains and losses.

13 Deferred tax

Deferred tax assets comprise:

	Stock relief £m	Excess of depreciation over capital allowances £m	Tax losses £m	Retirement benefits £m	Fair value losses/(gains) £m	Other temporary differences £m	Total £m
At 1 January 2010	**33**	**62**	**51**	**109**	**6**	**268**	**529**
Exchange differences	**1**	**2**		**6**	**(1)**	**13**	**21**
Credited/(charged) to the income statement		**(2)**	**28**	**(15)**	**(20)**	**13**	**4**
Write-off of unutilised losses in Turkey (note 6(c))			**(35)**				**(35)**
Credited/(charged) to other comprehensive income			**(2)**	**14**	**19**	**(9)**	**22**
Other	**(3)**	**8**		**3**		**28**	**36**
At 31 December 2010	**31**	**70**	**42**	**117**	**4**	**313**	**577**
At 1 January 2009	29	56	64	144	17	245	555
Exchange differences	(1)	(4)	(5)	(5)	(2)		(17)
Credited/(charged) to the income statement	5	11	(9)	(8)		14	13
(Charged)/credited to other comprehensive income			4	(16)	(6)	(17)	(35)
Other		(1)	(3)	(6)	(3)	26	13
At 31 December 2009	33	62	51	109	6	268	529

Deferred tax liabilities comprise:

	Stock relief £m	Excess of capital allowances over depreciation £m	Undistributed earnings of associates and subsidiaries £m	Retirement benefits £m	Fair value (losses)/gains £m	Other temporary differences £m	Total £m
At 1 January 2010	**8**	**215**	**161**	**117**	**1**	**204**	**706**
Exchange differences	**1**	**7**	**6**	**(3)**		**1**	**12**
(Credited)/charged to the income statement	**6**	**(38)**	**(7)**	**7**		**(28)**	**(60)**
Credited to other comprehensive income				**(2)**			**(2)**
Other	**(3)**	**11**	**6**	**(2)**	**1**	**6**	**19**
At 31 December 2010	**12**	**195**	**166**	**117**	**2**	**183**	**675**
At 1 January 2009	13	207	160	162	1	219	762
Exchange differences		(12)	(6)	(14)		(21)	(53)
(Credited)/charged to the income statement	(5)	19	8	(21)		(26)	(25)
(Credited)/charged to other comprehensive income				(8)	(2)	3	(7)
Subsidiaries acquired						31	31
Other		1	(1)	(2)	2	(2)	(2)
At 31 December 2009	8	215	161	117	1	204	706

	2010 £m	2009 £m
Net deferred tax liabilities	**98**	177

Notes on the accounts (continued)

13 Deferred tax continued

The net deferred tax liabilities are reflected in the Group balance sheet as follows, after offsetting assets and liabilities where there is a legally enforceable right to offset current tax assets and liabilities and where the deferred income taxes relate to the same fiscal authority.

	2010 £m	2009 £m
Deferred tax assets	**(411)**	(350)
Deferred tax liabilities	**509**	527
	98	177

Deferred tax expected to be recovered within 12 months:

	2010 £m	2009 £m
Deferred tax assets	**(162)**	(99)
Deferred tax liabilities	**121**	95
	(41)	(4)

At the balance sheet date, the Group has unused tax losses of £421 million (2009: £597 million) which have no expiry date and unused tax losses of £538 million (2009: £331 million) which will expire within the next 10 years. No amount of deferred tax has been recognised in respect of these unused losses.

At the balance sheet date, the Group has not recognised a deferred tax asset in respect of deductible temporary differences of £795 million (2009: £1,092 million). These unrecognised deductible temporary differences have no expiry date.

At the balance sheet date, the Group has unused tax credits of £80 million (2009: £80 million) which have no expiry date. No amount of deferred tax has been recognised in respect of these unused tax credits.

At the balance sheet date, the aggregate amount of undistributed earnings of subsidiaries which would be subject to dividend withholding tax was £2 billion (2009: £2 billion). No liability has been recognised in respect of this withholding tax because the Group is in a position to control the timing of these distributions and it is probable that these distributions will not be made in the foreseeable future.

14 Trade and other receivables

	2010 £m	2009 £m
Trade receivables	**1,831**	1,732
Loans and other receivables	**644**	609
Prepayments and accrued income	**206**	174
	2,681	2,515
Current	**2,409**	2,344
Non-current	**272**	171
	2,681	2,515

Amounts receivable from related parties including associated undertakings are shown in note 29.

Trade and other receivables have been reported in the balance sheet net of allowances as follows:

	2010 £m	2009 £m
Gross trade and other receivables	**2,741**	2,586
Allowance account	**(60)**	(71)
Net trade and other receivables per balance sheet	**2,681**	2,515

14 Trade and other receivables continued

The movements in the allowance account are as follows:

	2010 £m	2009 £m
1 January	**71**	74
Differences on exchange	**3**	1
Provided in the year	**8**	21
Amounts reversed during the year	**(8)**	(5)
Amounts in respect of receivables written off	**(14)**	(20)
31 December	**60**	71

Impairment of trade receivables, including write-offs and allowances, charged during the year is included as part of other operating expenses. For 2010, the net impairment charged was £3 million (2009: £24 million) of which £nil (2009: £16 million), is reflected in the above table.

As at 31 December 2010, trade and other receivables of £58 million (2009: £57 million) were past their contractual payment date but not impaired. These relate to a number of external parties where there is no expectation of default. The aged analysis of these trade receivables is as follows:

	2010 £m	2009 £m
Less than three months	**52**	39
Between three and six months	**4**	8
Between six months and one year	**2**	6
Greater than one year		4

The Group holds bank guarantees, other guarantees and credit insurance in respect of some of the past due debtor balances.

Trade and other receivables are predominantly denominated in the functional currencies of subsidiary undertakings apart from the following:

	2010 £m	2009 £m
US dollar	**126**	118
UK sterling	**108**	92
Euro	**29**	30
Other currencies	**39**	52

Trade and other receivables also include certain interest-bearing amounts and their effective interest rates are as follows:

	2010 £m	2009 £m	2010 %	2009 %
Euro	**3**	4	**4.0**	4.0
Other currencies	**11**	12	**7.4**	7.8

There is no material difference between the above amounts for trade and other receivables and their fair value, due to the short-term duration of the majority of trade and other receivables. There is no concentration of credit risk with respect to trade receivables as the Group has a large number of internationally dispersed customers.

Notes on the accounts (continued)

15 Available-for-sale investments

	2010 £m	2009 £m
1 January	**83**	106
Differences on exchange	**(1)**	(2)
Additions and advances	**1**	251
Revaluations	**4**	3
Disposals and repayments		(275)
31 December	**87**	83
Current	**58**	57
Non-current	**29**	26
	87	83

The classification of these investments under the IFRS 7 fair value hierarchy is given in note 24.

Investments have the following maturities:

	As per balance sheet	
	2010 £m	2009 £m
Equity investments	**30**	28
Non-equity investments		
– within one year	**44**	44
– beyond one year and within two years	**11**	6
– beyond two years and within three years	**1**	5
– beyond five years	**1**	
	87	83

There is no material difference between the maturity profile of investments in the table above and the maturity profile on a contractual gross basis where the values in each year include the investments maturing in that year together with forecast interest receipts on all investments which are due for all or part of that year.

Investments are denominated in the functional currency of the subsidiary undertaking or other currencies as shown below:

	2010 £m	2009 £m
Functional currencies	**83**	79
US dollar	**2**	2
Other currencies	**2**	2
	87	83

Non-equity investments of £57 million (2009: £55 million) are principally denominated in UK sterling and have an effective interest rate of 1.4 per cent (2009: 4 per cent).

16 Derivative financial instruments

The fair values of derivatives are determined based on market data (primarily yield curves, implied volatilities and exchange rates) to calculate the present value of all estimated flows associated with each derivative at the balance sheet date. In the absence of sufficient market data, fair values would be based on the quoted market price of similar derivatives. The classification of these assets and liabilities under the IFRS 7 fair value hierarchy is given in note 24.

	2010		2009	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Fair value hedges				
– interest rate swaps	139	8	108	1
– cross-currency swaps	5	51	5	79
Cash flow hedges				
– forward foreign currency contracts	36	96	28	38
Net investment hedges				
– forward foreign currency contracts	52	60	59	39
Cash flow hedges and net investment hedges				
– bifurcated cross-currency swaps	11		10	
Held-for-trading*				
– forward foreign currency contracts	21	92	31	50
– others	9	12	8	14
Total	273	319	249	221
Current	145	227	156	127
Non-current	128	92	93	94
	273	319	249	221
Derivatives				
– in respect of net debt	171	149	149	127
– other	102	170	100	94
	273	319	249	221

* As explained in note 4, some derivative financial instruments are not designated as hedges and so are required to be classified as held-for-trading.

Notes on the accounts (continued)

16 Derivative financial instruments continued

The maturity dates of all derivative financial instruments as recognised in the balance sheet are as follows:

	2010		2009	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Within one year	**145**	**227**	156	127
Between one and two years	**11**	**18**	7	2
Between two and three years	**36**	**5**	23	
Between three and four years	**31**		31	6
Between four and five years			4	2
Beyond five years	**50**	**69**	28	84
	273	**319**	249	221

For cash flow hedges, including bifurcated hedges, the timing of expected cash flows is as follows:

	2010		2009	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Within one year	**75**	**77**	33	36
Between one and two years	**2**	**18**	50	2
Between two and three years		**1**	2	
	77	**96**	85	38
Less: bifurcated cross-currency swap designated as a net investment hedge	**(30)**		(47)	
	47	**96**	38	38

The Group has a receive €465 million fixed rate pay DKK3,468 million fixed rate cross-currency swap which has been bifurcated into a receive €465 million fixed rate pay £368 million fixed rate cross-currency swap designated as a cash flow hedge and a receive £368 million fixed rate pay DKK3,468 million fixed rate cross-currency swap designated as a net investment hedge. The above table includes the timing of expected cash flows on the bifurcated cross-currency swap designated as a cash flow hedge.

The Group's cash flow hedges are principally in respect of sales or purchases of inventory and certain debt instruments. The timing of expected cash flows in respect of derivatives designated as cash flow hedges is broadly expected to be comparable to the timing of when the hedged item will affect profit or loss.

16 Derivative financial instruments continued

The tables below set out the maturities of the Group's derivative financial instruments on an undiscounted contractual basis, based on spot rates.

The maturity dates of all gross settled derivative financial instruments are as follows:

	2010				2009			
	Assets		Liabilities		Assets		Liabilities	
	Inflow £m	Outflow £m	Inflow £m	Outflow £m	Inflow £m	Outflow £m	Inflow £m	Outflow £m
Within one year								
– forward contracts	**4,182**	**(4,075)**	**6,987**	**(7,219)**	4,437	(4,327)	4,769	(4,904)
– cross-currency swaps	**430**	**(419)**	**18**	**(8)**	25	(26)	18	(8)
– other	**1,379**	**(1,373)**	**1,371**	**(1,381)**	1,282	(1,276)	1,273	(1,284)
Between one and two years								
– forward contracts	**167**	**(164)**	**364**	**(378)**	270	(261)	167	(168)
– cross-currency swaps	**1**		**18**	**(9)**	446	(435)	18	(13)
Between two and three years								
– forward contracts			**39**	**(40)**	44	(41)	14	(13)
– cross-currency swaps	**1**		**18**	**(14)**	1	(1)	18	(17)
Between three and four years								
– cross-currency swaps	**1**	**(1)**	**18**	**(16)**	1	(1)	18	(18)
Between four and five years								
– cross-currency swaps	**1**	**(1)**	**18**	**(18)**	1	(1)	18	(19)
Beyond five years								
– cross-currency swaps	**20**	**(16)**	**343**	**(419)**	22	(17)	361	(458)
	6,182	**(6,049)**	**9,194**	**(9,502)**	6,529	(6,386)	6,674	(6,902)

The maturity dates of net settled derivative financial instruments are as follows:

	2010		2009	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Within one year	**54**	**(1)**	43	(10)
Between one and two years	**40**	**(7)**	35	(2)
Between two and three years	**19**	**(2)**	18	6
Between three and four years	**15**	**1**	3	7
Between four and five years	**8**	**3**	3	7
Beyond five years	**22**	**32**	15	
	158	**26**	117	8

The above analysis of derivatives settled on a net basis primarily relates to the Group's interest rate swaps.

In summary by type, the fair value of derivative financial instruments is as follows:

	2010		2009	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Interest rate swaps	**139**	**8**	108	1
Cross-currency swaps	**16**	**51**	15	79
Forward foreign currency contracts	**109**	**248**	118	127
Others	**9**	**12**	8	14
	273	**319**	249	221

Notes on the accounts (continued)

16 Derivative financial instruments continued

(a) Interest rate swaps

2010

	Maturity date	Principal currency	m	£m	Interest rate % Original	Interest rate % Swapped	Assets £m	Liabilities £m
Fixed to floating	**2012**	**EUR**	**337**	**289**	**3.6**	**note (a)**	**14**	
	2013	**EUR**	**400**	**343**	**5.1**	**note (a)**	**31**	
	2013	**GBP**	**150**	**150**	**5.8**	**note (a)**	**12**	
	2014	**GBP**	**500**	**500**	**6.0**	**note (a)**	**20**	
	2014	**GBP**	**250**	**250**	**6.0**	**note (a)**	**20**	
	2019	**GBP**	**250**	**250**	**6.4**	**note (a)**	**39**	
	2020	**EUR**	**600**	**514**	**4.0**	**note (a)**		**8**
Floating to fixed	**2017**	**EUR**	**600**	**514**	**note (a)**	**3.7**	**3**	
							139	**8**

2009

	Maturity date	Principal currency	m	£m	Interest rate % Original	Interest rate % Swapped	Assets £m	Liabilities £m
Fixed to floating	2012	EUR	750	666	3.6	note (a)	33	
	2013	EUR	400	355	5.1	note (a)	31	
	2013	GBP	150	150	5.8	note (a)	8	
	2014	GBP	500	500	6.0	note (a)		1
	2014	GBP	250	250	6.0	note (a)	11	
	2015	EUR	650	578	4.9	note (a)	1	
	2019	GBP	250	250	6.4	note (a)	24	
							108	1

Note (a): The floating rate interest rates are based on LIBOR (or local equivalent) plus a margin ranging between 35 and 268 basis points (2009: 32 and 268 basis points).

These swaps have been used to manage the interest rate profile of external borrowings and are reflected in the repricing table in note 21.

(b) Cross-currency swaps

2010

	Maturity date	Original currency	Interest rate %	Principal original currency m	£m	Swapped currency	Interest rate %	Principal swapped currency m	£m	Assets £m	Liabilities £m
Fixed to fixed	**2011**	**EUR**	**5.9**	**465**	**398**	**DKK**	**6.2**	**3,468**	**399**	**11**	
Fixed to floating	**2016**	**GBP**	**5.5**	**325**	**325**	**EUR**	**note (b)**	**473**	**405**		**51**
	2019	**EUR**	**4.6**	**20**	**17**	**USD**	**note (b)**	**22**	**14**	**5**	
										16	**51**

2009

	Maturity date	Original currency	Interest rate %	Principal original currency m	£m	Swapped currency	Interest rate %	Principal swapped currency m	£m	Assets £m	Liabilities £m
Fixed to fixed	2011	EUR	5.9	465	413	DKK	6.2	3,468	414	10	
Fixed to floating	2016	GBP	5.5	325	325	EUR	note (b)	473	420		79
	2019	EUR	4.6	20	18	USD	note (b)	22	14	5	
										15	79

Note (b): The floating rate interest rates are based on LIBOR (or local equivalent) plus a margin ranging between 82 and 83 basis points for 2010 and 2009.

16 Derivative financial instruments continued

(c) Forward foreign currency contracts

Forward foreign currency contracts are denominated in the following currencies:

Fair values of assets

	2010 Currencies purchased forward					2009 Currencies purchased forward				
	GBP £m	USD £m	EUR £m	Others £m	Total £m	GBP £m	USD £m	EUR £m	Others £m	Total £m
Currencies sold forward										
AUD						3				3
EUR	11	10		4	25	29	5		1	35
GBP		5	10	14	29		2	1	5	8
JPY							11			11
RUR							1			1
USD	36		2	7	45	46		1	3	50
Other currencies	6	1	2	1	10	9		1		10
	53	16	14	26	109	87	19	3	9	118

Fair values of liabilities

	2010 Currencies purchased forward					2009 Currencies purchased forward				
	GBP £m	USD £m	EUR £m	Others £m	Total £m	GBP £m	USD £m	EUR £m	Others £m	Total £m
Currencies sold forward										
AUD	37	6	1		44	11	5	1		17
BRL		4			4					
CAD	15	2			17	17	2			19
CHF	24		9		33	3		1		4
EUR	27	6		1	34	7	7			14
GBP		6	2		8		2	7	2	11
JPY		52			52		6			6
NOK			4		4			4	1	5
SGD						2				2
USD	13		1		14	13		1	1	15
ZAR	22		1		23	18	1	1		20
Other currencies	8	2	4	1	15	3	5	6		14
	146	78	22	2	248	74	28	21	4	127

Notes on the accounts (continued)

16 Derivative financial instruments continued

Forward foreign currency contracts have been used to hedge both internal and external forecast transactions as well as the hedging of internal and external assets and liabilities. Certain contracts were used to manage the currency profile of external borrowings and are reflected in the currency table in note 21, and their nominal values are as follows:

	2010		2009	
	Purchase £m	Sell £m	Purchase £m	Sell £m
Forward contracts to purchase GBP, sell CHF	**(181)**	**189**	(167)	165
Forward contracts to purchase GBP, sell CAD	**(292)**	**299**	(401)	413
Forward contracts to purchase GBP, sell AUD	**(1,074)**	**1,048**	(942)	947
Forward contracts to purchase EUR, sell DKK			(177)	177
Forward contracts to purchase EUR, sell SEK	**(130)**	**132**	(175)	177
Forward contracts to purchase EUR, sell NOK	**(160)**	**164**	(156)	160
Forward contracts to purchase EUR, sell GBP	**(372)**	**367**	(218)	221

(d) Others

	2010		2009	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Others: Bund forwards (note i)	**5**	**7**	4	7
Interest derivative (note ii)		**5**		7
Sinking fund policy (note iii)	**4**		4	
	9	**12**	8	14

Notes:
(i) Forward contracts to purchase and sell German government securities with a nominal value of €1.6 billion (2009: €1.4 billion) taken out to manage internal financing arrangements and maturing within one year.
(ii) Remaining impact of an interest derivative with a nominal value of €1 billion maturing in 2013.
(iii) Investment in sinking fund policy with a nominal value of ZAR 33 million (2009: ZAR 46 million).

17 Inventories

	2010 £m	2009 £m
Raw materials and consumables	**1,893**	1,587
Finished goods and work in progress	**1,531**	1,443
Goods purchased for resale	**184**	231
	3,608	3,261

Inventories pledged as security for liabilities amount to £17 million (2009: £10 million). Write-offs taken to other operating expenses in the Group income statement comprise £45 million (2009: £63 million), including amounts relating to restructuring costs.

18 Income tax receivable and payable

Income tax balances shown on the Group balance sheet as current assets and current liabilities, while subject to some uncertainty as to the extent and timing of cash flows, are largely expected to be received or paid within 12 months at the balance sheet date for both 2010 and 2009.

19 Cash and cash equivalents

	2010 £m	2009 £m
Cash and bank balances	**943**	965
Cash equivalents	**1,386**	1,196
	2,329	2,161

Cash equivalents mainly comprise short-term deposits and investments in money market funds with an original maturity of three months or less. The carrying value of cash and cash equivalents approximates their fair value.

Cash and cash equivalents are denominated in the functional currency of the subsidiary undertaking or other currencies as shown below:

	2010 £m	2009 £m
Functional currency	**2,131**	1,687
US dollar	**102**	128
UK sterling	**10**	6
Euro	**14**	262
Other currencies	**72**	78
	2,329	2,161

The currency in which cash and cash equivalents are held, together with the effective interest rates applicable to cash and cash equivalents are as follows:

	Values		Rates	
	2010 £m	2009 £m	2010 %	2009 %
US dollar	**305**	221	**0.8**	0.9
UK sterling	**652**	437	**0.5**	0.4
Euro	**95**	340	**0.4**	0.4
Canadian dollar	**3**	43	**1.0**	0.4
Australian dollar	**86**	53	**4.5**	3.3
Other currencies	**1,188**	1,067	**5.3**	5.3
	2,329	2,161		

In the Group cash flow statement, net cash and cash equivalents are shown after deducting bank overdrafts and accrued interest, as follows:

	2010 £m	2009 £m
Cash and cash equivalents as above	**2,329**	2,161
Less		
– accrued interest	**(1)**	(1)
– overdrafts	**(145)**	(181)
Net cash and cash equivalents	**2,183**	1,979

Cash and cash equivalents include restricted amounts of £82 million (2009: £80 million), principally due to exchange control regulations in certain countries.

Notes on the accounts (continued)

20 Capital and reserves – reconciliation of movement in total equity

	Attributable to owners of the parent						
	Share capital £m	Share premium, capital redemption and merger reserves £m	Other reserves £m	Retained earnings £m	Total attributable to owners of the parent £m	Non-controlling interests £m	Total equity £m
1 January 2010	506	3,907	1,032	2,168	7,613	299	7,912
Comprehensive income and expense							
Profit for the year				2,879	2,879	261	3,140
Differences on exchange							
– subsidiaries			484		484	18	502
– associates			105		105		105
Differences on exchange reclassified and reported in profit for the year			(3)		(3)		(3)
Cash flow hedges							
– net fair value losses			(106)		(106)		(106)
– reclassified and reported in profit for the year			55		55		55
– reclassified and reported in net assets			3		3		3
Available-for-sale investments							
– net fair value gains			4		4		4
Net investment hedges							
– net fair value losses			(31)		(31)		(31)
– differences on exchange on borrowings			71		71	3	74
Retirement benefit schemes							
– actuarial gains/(losses) in respect of subsidiaries (note 12)				198	198	(5)	193
– surplus recognition and minimum funding obligations in respect of subsidiaries (note 12)				57	57	1	58
– actuarial losses in respect of associates net of tax (note 11)				(54)	(54)		(54)
Tax on other items recognised directly in other comprehensive income (note 6(d))			(14)	16	2	(1)	1
Other changes in equity							
Employee share options							
– value of employee services				67	67		67
– proceeds from shares issued		3		4	7		7
Dividends and other appropriations							
– ordinary shares				(2,093)	(2,093)		(2,093)
– to non-controlling interests						(234)	(234)
Purchase of own shares							
– held in employee share ownership trusts				(66)	(66)		(66)
Non-controlling interests – acquisitions (note 29)				(12)	(12)		(12)
Other movements				26	26		26
31 December 2010	506	3,910	1,600	3,190	9,206	342	9,548

20 Capital and reserves – reconciliation of movement in total equity (continued)

	Attributable to owners of the parent						
	Share capital £m	Share premium, capital redemption and merger reserves £m	Other reserves £m	Retained earnings £m	Total attributable to owners of the parent £m	Non-controlling interests £m	Total equity £m
1 January 2009	506	3,905	955	1,578	6,944	271	7,215
Comprehensive income and expense							
Profit for the year				2,713	2,713	243	2,956
Differences on exchange							
– subsidiaries			142		142	24	166
– associates			(258)		(258)		(258)
Cash flow hedges							
– net fair value losses			(72)		(72)		(72)
– reclassified and reported in profit for the year			67		67		67
– reclassified and reported in net assets			(1)		(1)		(1)
Available-for-sale investments							
– net fair value gains			3		3		3
– reclassified and reported in profit for the year			(3)		(3)		(3)
Net investment hedges							
– net fair value gains			238		238		238
– differences on exchange on borrowings			12		12		12
Retirement benefit schemes							
– actuarial losses in respect of subsidiaries (note 12)				(292)	(292)	(3)	(295)
– surplus recognition and minimum funding obligations in respect of subsidiaries (note 12)				(75)	(75)	(1)	(76)
– actuarial gains in respect of associates net of tax (note 11)				61	61		61
Tax on other items recognised directly in other comprehensive income (note 6(d))			(51)	(8)	(59)	(12)	(71)
Other changes in equity							
Employee share options							
– value of employee services				61	61		61
– proceeds from shares issued		2		5	7		7
Dividends and other appropriations							
– ordinary shares				(1,798)	(1,798)		(1,798)
– to non-controlling interests						(240)	(240)
Purchase of own shares							
– held in employee share ownership trusts				(94)	(94)		(94)
Non-controlling interests – acquisitions (note 26)						1	1
Non-controlling interests – capital injection (note 29)						16	16
Other movements				17	17		17
31 December 2009	506	3,907	1,032	2,168	7,613	299	7,912

Details relating to the allotted share capital, and movements therein, are included in note 4 of the Parent Company financial statements.

Notes on the accounts (continued)

20 Capital and reserves – reconciliation of movement in total equity continued

Share premium account, capital redemption reserves and merger reserves comprise:

	Share premium account £m	Capital redemption reserves £m	Merger reserves £m	Total £m
1 January 2009	56	101	3,748	3,905
31 December 2009	58	101	3,748	3,907
31 December 2010	**61**	**101**	**3,748**	**3,910**

The share premium account includes the difference between the value of shares issued and their nominal value. The increase of £3 million (2009: £2 million) relates solely to ordinary shares issued under the Company's share option schemes. These schemes are described in the Remuneration Report.

On the purchase of own shares as part of the share buy-back programme for shares which are cancelled, a transfer is made from retained earnings to the capital redemption reserve equivalent to the nominal value of shares purchased. Purchased shares which are not cancelled are classified as treasury shares and presented as a deduction from total equity.

Total equity attributable to owners of the parent is stated after deducting the cost of treasury shares which include £523 million (2009: £523 million) for shares repurchased and not cancelled and £227 million (2009: £249 million) in respect of the cost of own shares held in employee share ownership trusts.

In 1999, shares were issued for the acquisition of the Rothmans International B.V. Group, and the difference between the fair value of shares issued and their nominal value was credited to merger reserves.

20 Capital and reserves – reconciliation of movement in total equity continued

Movements in other reserves and retained earnings (which is after deducting treasury shares) shown above comprise:

	Translation reserve £m	Hedging reserve £m	Available-for-sale reserve £m	Revaluation reserve £m	Other £m	Total other reserves £m	Retained earnings: Treasury shares £m	Retained earnings: Other £m
1 January 2010	275	(6)	11	179	573	1,032	(772)	2,940
Comprehensive income and expense								
Profit for the year								2,879
Differences on exchange								
– subsidiaries	484					484		
– associates	105					105		
Differences on exchange reclassified and reported in profit for the year	(3)					(3)		
Cash flow hedges								
– net fair value losses		(106)				(106)		
– reclassified and reported in profit for the year		55				55		
– reclassified and reported in net assets		3				3		
Available-for-sale investments								
– net fair value gains			4			4		
Net investment hedges								
– net fair value losses	(31)					(31)		
– differences on exchange on borrowings	71					71		
Retirement benefit schemes								
– actuarial gains in respect of subsidiaries (note 12)								198
– surplus recognition and minimum funding obligations in respect of subsidiaries (note 12)								57
– actuarial losses in respect of associates net of tax (note 11)								(54)
Tax on items recognised directly in other comprehensive income (note 6(d))	(33)	19				(14)		16
Other changes in equity								
Employee share options								
– value of employee services								67
– proceeds from shares issued							4	
Dividends and other appropriations								
– ordinary shares								(2,093)
Purchase of own shares								
– held in employee share ownership trusts							(66)	
Non-controlling interests – acquisitions								(12)
Other movements							84	(58)
31 December 2010	868	(35)	15	179	573	1,600	(750)	3,940

Notes on the accounts (continued)

20 Capital and reserves – reconciliation of movement in total equity continued

	Translation reserve £m	Hedging reserve £m	Available-for-sale reserve £m	Revaluation reserve £m	Other £m	Total other reserves £m	Retained earnings: Treasury shares £m	Retained earnings: Other £m
1 January 2009	188	4	11	179	573	955	(745)	2,323
Comprehensive income and expense								
Profit for the year								2,713
Differences on exchange								
– subsidiaries	142					142		
– associates	(258)					(258)		
Cash flow hedges								
– net fair value losses		(72)				(72)		
– reclassified and reported in profit for the year		67				67		
– reclassified and reported in net assets		(1)				(1)		
Available-for-sale investments								
– net fair value gains			3			3		
– reclassified and reported in profit for the year			(3)			(3)		
Net investment hedges								
– net fair value gains	238					238		
– differences on exchange on borrowings	12					12		
Retirement benefit schemes								
– actuarial losses in respect of subsidiaries (note 12)								(292)
– surplus recognition and minimum funding obligations in respect of subsidiaries (note 12)								(75)
– actuarial gains in respect of associates net of tax (note 11)								61
Tax on items recognised directly in other comprehensive income (note 6(d))	(47)	(4)				(51)		(8)
Other changes in equity								
Employee share options								
– value of employee services								61
– proceeds from shares issued							5	
Dividends and other appropriations								
– ordinary shares								(1,798)
Purchase of own shares								
– held in employee share ownership trusts							(94)	
Other movements							62	(45)
31 December 2009	275	(6)	11	179	573	1,032	(772)	2,940

The translation reserve is as explained in the accounting policy on foreign currencies in note 1.

The hedging reserve and the available-for-sale reserve are as explained in the accounting policy on financial instruments in note 1.

The revaluation reserve relates to the acquisition of the cigarette and snus business of ST in 2008.

Of the amounts released from the hedging reserve during the year, losses of £4 million (2009: £4 million loss) and losses of £38 million (2009: £9 million gain) were reported within revenue and raw materials and consumables respectively, together with a gain of £3 million (2009: £14 million gain) reported in other operating expenses and a loss of £16 million (2009: £86 million loss) reported within net finance costs.

20 Capital and reserves – reconciliation of movement in total equity continued

Other reserves comprise:

(a) £483 million which arose in 1998 from merger accounting in a Scheme of Arrangement and Reconstruction whereby British American Tobacco p.l.c. acquired the entire share capital of B.A.T Industries p.l.c. and the share capital of that company's principal financial services subsidiaries was distributed, so effectively demerging them; and

(b) In the Rothmans transaction, convertible redeemable preference shares were issued as part of the consideration. The discount on these shares was amortised by crediting other reserves and charging retained earnings. The £90 million balance in other reserves comprises the accumulated balance in respect of the preference shares converted during 2004.

The tax attributable to components of other comprehensive income is as follows:

	2010 £m	2009 £m
Translation reserve		
Differences on exchange	**(4)**	(42)
Net investment hedges		
– difference on exchange on borrowings	**(29)**	(5)
	(33)	(47)
Hedging reserve		
Cash flow hedges		
– net fair value (losses)/gains	**27**	(4)
– reclassified and reported in profit for the year	**(8)**	
	19	(4)
Retained earnings		
– actuarial (losses)/gains in respect of subsidiaries	**31**	(31)
– surplus recognition and minimum funding obligations in respect of subsidiaries	**(15)**	23
	16	(8)
Owners of the parent	**2**	(59)
Non-controlling interests	**(1)**	(12)
Total tax recognised in other comprehensive income for the period (note 6(d))	**1**	(71)

Notes on the accounts (continued)

21 Borrowings

	Currency	Maturity dates	Interest rates	2010 £m	2009 £m
Eurobonds	Euro	2011 to 2021	3.6% to 5.9%	**5,064**	5,500
	UK sterling	2013 to 2040	5.5% to 7.3%	**2,626**	2,297
Bonds issued pursuant to Rule 144A and RegS under the US Securities Act (as amended)	US dollar	2013 to 2018	8.1% to 9.5%	**637**	620
Floating rate notes	Euro	2010	floating rate		467
Other notes	Malaysian ringgit	2012 to 2014	4.1% to 4.5%	**136**	119
	Indonesian rupiah	2012	10.5%	**96**	90
	Other currencies			**26**	25
Syndicated bank loans	US dollar	2012	floating rate	**442**	427
	Euro	2012 to 2013	floating rate	**382**	613
Euro commercial paper					187
Bank loans				**629**	519
Other loans				**47**	2
Finance leases				**20**	35
Overdrafts				**145**	181
				10,250	11,082

The floating rate interest rates referred to in the table above are based on EURIBOR or USD LIBOR plus a margin ranging between 28 and 105 basis points (2009: 28 and 225 basis points).

	2010 £m	2009 £m
Current	**1,334**	1,370
Non-current	**8,916**	9,712
	10,250	11,082

Current borrowings include interest payable of £242 million at 31 December 2010 (2009: £232 million). Included within non-current borrowings are £2,595 million (2009: £3,019 million) of borrowings subject to fair value hedges where their amortised cost has been increased by £150 million (2009: £96 million) in the table above.

The fair value of borrowings is estimated to be £10,963 million (2009: £11,646 million) and has been determined using quoted market prices or discounted cash flow analysis.

	2010 £m	2009 £m
Amounts secured on Group assets	**61**	59

Amounts secured include finance leases of £20 million (2009: £35 million) and the remaining amounts are secured on certain property and inventory of the Group (note 10 and note 17).

Borrowings are repayable as follows:

	Per balance sheet		Contractual gross maturities	
	2010 £m	2009 £m	2010 £m	2009 £m
Within one year	**1,334**	1,370	**1,389**	1,404
Between one and two years	**1,057**	1,083	**1,382**	1,440
Between two and three years	**1,232**	1,895	**1,740**	2,463
Between three and four years	**617**	844	**1,021**	1,199
Between four and five years	**1,067**	624	**1,430**	996
Beyond five years	**4,943**	5,266	**7,061**	7,264
	10,250	11,082	**14,023**	14,766

The contractual gross maturities in each year include the borrowings maturing in that year together with forecast interest payments on all borrowings which are outstanding for all or part of that year.

21 Borrowings continued

Borrowings are denominated in the functional currency of the subsidiary undertaking or other currencies as shown below:

	Functional currency £m	US dollar £m	UK sterling £m	Euro £m	Canadian dollar £m	Australian dollar £m	Other currencies £m	Total £m
31 December 2010								
Total borrowings	**5,111**	**1,277**	**329**	**3,524**	**1**		**8**	**10,250**
Effect of derivative financial instruments								
– cross-currency swaps		**14**	**(325)**	**(10)**			**399**	**78**
– forward foreign currency contracts	**(1,180)**			**(662)**	**299**	**1,048**	**485**	**(10)**
	3,931	**1,291**	**4**	**2,852**	**300**	**1,048**	**892**	**10,318**
31 December 2009								
Total borrowings	4,718	1,155	328	4,863			18	11,082
Effect of derivative financial instruments								
– cross-currency swaps		14	(325)	(10)			413	92
– forward foreign currency contracts	(1,289)			(726)	413	947	679	24
	3,429	1,169	3	4,127	413	947	1,110	11,198

Details of the derivative financial instruments included in these tables are given in note 16.

The exposure to interest rate changes when borrowings are repriced is as follows:

	Within 1 year £m	Between 1-2 years £m	Between 2-3 years £m	Between 3-4 years £m	Between 4-5 years £m	Beyond 5 years £m	Total £m
31 December 2010							
Total borrowings	**2,179**	**616**	**851**	**617**	**1,067**	**4,920**	**10,250**
Effect of derivative financial instruments							
– interest rate swaps	**1,782**	**(289)**	**(493)**	**(750)**		**(250)**	
– cross-currency swaps	**419**					**(342)**	**77**
	4,380	**327**	**358**	**(133)**	**1,067**	**4,328**	**10,327**
31 December 2009							
Total borrowings	1,439	1,442	1,467	844	624	5,266	11,082
Effect of derivative financial instruments							
– interest rate swaps	2,749		(666)	(505)	(750)	(828)	
– cross-currency swaps	434					(343)	91
	4,622	1,442	801	339	(126)	4,095	11,173

Details of the derivative financial instruments included in these tables are given in note 16.

Notes on the accounts (continued)

21 Borrowings continued

Effective interest rates are as follows:

	2010 £m	2009 £m	2010 %	2009 %
US dollar	**1,346**	1,223	**5.5**	5.7
UK sterling	**2,646**	2,284	**6.3**	6.3
Euro	**5,473**	6,780	**5.1**	4.6
Canadian dollar	**9**	13	**5.4**	5.6
Other currencies	**776**	782	**6.8**	6.0
	10,250	11,082		

The values and rates shown above do not reflect the effect of the interest rate and cross-currency swaps detailed in note 16.

Finance lease liabilities per the balance sheet and on a contractual gross maturity basis are payable as follows:

			2010			2009
	Principal £m	Interest £m	Total £m	Principal £m	Interest £m	Total £m
Within one year	**11**	**1**	**12**	17	1	18
Between one and two years	**5**		**5**	10	1	11
Between two and three years	**2**		**2**	4		4
Between three and four years	**1**		**1**	2		2
Between four and five years				1		1
Beyond five years	**1**		**1**	1		1
	20	**1**	**21**	35	2	37

Borrowings facilities

	2010 £m	2009 £m
Undrawn committed facilities expiring		
– within one year	**282**	436
– between one and two years		130
– between two and three years		1,651
– between three and four years		
– between four and five years	**2,000**	
	2,282	2,217

In December 2010 the Group negotiated a new central banking facility of £2 billion with a final maturity date of December 2015. The existing central banking facility of £1.75 billion, with a final maturity date of March 2012 was cancelled at the same time. The new facility was undrawn as at 31 December 2010.

The Group defines net debt as follows:

	2010 £m	2009 £m
Borrowings (note 21)	**10,250**	11,082
Derivatives in respect of net debt:		
– assets (note 16)	**(171)**	(149)
– liabilities (note 16)	**149**	127
Cash and cash equivalents (note 19)	**(2,329)**	(2,161)
Current available-for-sale investments (note 15)	**(58)**	(57)
	7,841	8,842

22 Other provisions for liabilities and charges

	Restructuring of existing businesses £m	Employee related benefits £m	Other provisions £m	Total £m
1 January 2010	195	38	223	456
Differences on exchange		3	6	9
Provided in respect of the year	76	12	26	114
Utilised during the year	(68)	(4)	(46)	(118)
Other movements	4	(1)	5	8
31 December 2010	207	48	214	469
Analysed on the balance sheet as				
– current	138	16	128	282
– non-current	69	32	86	187
	207	48	214	469

The restructuring provisions relate to the restructuring and integration costs incurred and reported as adjusting items in the income statement. The principal restructuring activities in 2010 and 2009 are as described in note 3(e). While some elements of the non-current provisions of £69 million will unwind over several years, as termination payments are made over extended periods in some countries, it is estimated that over 50 per cent will unwind in 2011 and over 80 per cent within five years.

In the prior year, the Group presented provisions in respect of acquired businesses separately from provisions for restructuring of existing businesses. Provisions for restructuring of acquired businesses mostly relate to those which were part of the integration of the Rothmans businesses in 1999 and the reorganisation of the Italian business acquired in 2003. These provisions are no longer significant in either the current or prior year and are now presented as part of provisions for restructuring of existing businesses.

Employee related benefits mainly relate to long-term employee benefits other than post-retirement benefits. As the principal components of these provisions are long service awards and 'jubilee' payments due after a certain service period, they will unwind over several years. It is estimated that approximately 40 per cent of the non-current provisions of £32 million will unwind within five years.

Other provisions comprise balances set up in the ordinary course of general business that cannot be classified within the other categories, such as sales returns, onerous contracts, together with amounts in respect of supplier, excise and other disputes. The nature of the amounts provided in respect of disputes is such that the extent and timing of cash flows is difficult to estimate and the ultimate liability may vary from the amounts provided.

Amounts provided above are shown net of reversals of unused provisions which include £12 million for restructuring of existing businesses, £3 million for employee benefits and £59 million for other provisions.

Notes on the accounts (continued)

23 Trade and other payables

	2010 £m	2009 £m
Trade payables	**712**	650
Duty, excise and other taxes	**3,306**	2,909
Accrued charges and deferred income	**1,088**	943
Social security and other taxation	**15**	19
Sundry payables	**407**	386
	5,528	4,907
Current	**5,335**	4,727
Non-current	**193**	180
	5,528	4,907

Accrued charges and deferred income include £30 million (2009: £19 million) in respect of interest payable. Amounts payable to related parties including associated undertakings are shown in note 29.

There is no material difference between the above amounts for trade and other payables and their fair value, due to the short-term duration of the majority of trade and other payables.

Trade and other payables are predominantly denominated in the functional currencies of subsidiary undertakings with less than 5 per cent in other currencies.

24 Financial instruments

Management of financial risks

One of the principal responsibilities of Treasury is to manage the financial risks arising from the Group's underlying operations. Specifically, Treasury manages, within an overall policy framework set by the Group's Main Board and Corporate Finance Committee (CFC), the Group's exposure to funding and liquidity, interest rate, foreign exchange and counterparty risks. The Group's treasury position is monitored by the CFC which meets regularly throughout the year and is chaired by the Group Finance Director. The approach is one of risk reduction within an overall framework of delivering total shareholder return.

The Group defines capital as net debt (see note 21) and equity (see note 20). The only externally imposed capital requirement for the Group is interest cover as described under interest rate risk below. The Group assesses its financial capacity by reference to cash flow, net debt and interest cover. Group policies include a set of financing principles and key performance indicators including the monitoring of credit ratings, interest cover and liquidity. These provide a framework within which the Group's capital base is managed and, in particular, the policies on dividends (as a percentage of long-term sustainable earnings) and share buy-back are decided. The key objective of the financing principles is to appropriately balance the interests of equity and debt holders in driving an efficient financing mix for the Group.

The Group manages its financial risks in line with the classification of its financial assets and liabilities in the Group's balance sheet and related notes.

The Group's management of specific risks is dealt with as follows:

Liquidity risk

It is the policy of the Group to maximise financial flexibility and minimise refinancing risk by issuing debt with a range of maturities, generally matching the projected cash flows of the Group and obtaining this financing from a wide range of providers. The Group has a target average centrally managed debt maturity of at least 5 years with no more than 20 per cent of centrally managed debt maturing in a single rolling year. As at 31 December 2010, the average centrally managed debt maturity was 7.4 years (2009: 6.6 years) and the highest proportion of centrally managed debt maturing in a single rolling year was 12.5 per cent (2009: 18.4 per cent). It is Group policy that short-term sources of funds (including drawings under the £1 billion Euro commercial paper (ECP) programme) are backed by undrawn committed lines of credit and cash. The ECP programme was undrawn at 31 December 2010 (2009: £187 million outstanding).

In December 2010, the Group negotiated a new central banking facility of £2 billion with a final maturity date of December 2015. This facility is provided by 22 banks. The existing central banking facility of £1.75 billion, with a final maturity date of March 2012 was cancelled at the same time. The new facility was undrawn as at 31 December 2010.

On 25 June 2010, the terms of €470 million of the €1 billion bond maturing in 2011 were modified by extending the maturity to 2020; at the same time, the Group issued an additional €130 million bond with a maturity of 2020. In addition, €413 million of the Group's €750 million bond maturing in 2012 was purchased and cancelled. At the same time, the Group issued a new £275 million bond with a maturity of 2040.

24 Financial instruments continued

In May 2010, the Group repaid a €525 million bond. The repayment was financed from debt issued in November 2009.

In 2010, the Group's subsidiary in Brazil received proceeds of £410 million (2009: £293 million) from short-term borrowings in respect of advance payments on leaf export contracts and repaid £297 million (2009: £241 million) in the year.

In November 2009, the terms of €481 million of the €1 billion bond maturing in 2013 were modified by extending the maturity to 2021. At the same time, the Group issued an additional €169 million bond with a maturity of 2021. In addition, £199 million of the £350 million bond maturing in 2013 was purchased and cancelled; at the same time the Group issued a new £500 million bond with a maturity of 2034.

In September 2009 and October 2009, the Group repaid its €359 million and €759 million credit facilities used to finance the acquisition of Tekel in 2008. The €759 million facility was refinanced by a new €700 million term loan facility with a maturity date of 31 October 2012 with an option to extend it to October 2013, at the discretion of the banking participants in the syndicated facility. In December 2010, the €700 million term loan facility was partly prepaid and the remaining term loan facility of €450 million was extended to October 2013 with the Group able to negotiate improved pricing.

In February 2009, the Group repaid a €900 million bond which was financed by bond issues during 2008 and cash generated from operations. In May 2009, the Group repaid Malaysian ringgit (MYR) 100 million which was refinanced in August 2009 by a new MYR250 million bond, due 2014. The additional proceeds were used to repay MYR150 million in November 2009. During 2009, the Group also issued a new £250 million bond maturing in June 2022.

The Group utilises cash pooling and zero balancing bank account structures in addition to inter-company loans and borrowings to ensure that there is the maximum mobilisation of cash within the Group. The key objectives of Treasury in respect of cash and cash equivalents are to protect the principal value of cash and cash equivalents, to concentrate cash at the centre to minimise the required long-term debt issuance, and to optimise the yield earned. The amount of debt issued by the Group is determined by forecasting the net debt requirement after the mobilisation of cash.

The Group continues to target investment-grade credit ratings; as at 31 December 2010 the ratings from Moody's and S&P were Baa1/BBB+ (2009: Baa1/BBB+) and these ratings were maintained throughout the year. The strength of the ratings has underpinned the debt issuance during 2010 and 2009 and, despite the impact of the turbulence in financial markets, the Group is confident of its ability to successfully access the debt capital markets, as demonstrated with the issue of bonds in the euro and sterling markets in 2010 and 2009.

As part of its short-term cash management, the Group invests in a range of cash and cash equivalents, including money market funds, which are regarded as highly liquid and are not exposed to significant changes in fair value. These are kept under continuous review as described in the credit risk section below. At 31 December 2010, cash and cash equivalents include £642 million invested in money market funds (2009: £669 million).

Subsidiary companies are funded by share capital and retained earnings, loans from the central finance companies on commercial terms, or through local borrowings by the subsidiaries in appropriate currencies. All contractual borrowing covenants have been met and none of them is expected to inhibit the Group's operations or funding plans.

Currency risk

The Group is subject to exposure on the translation of the net assets of foreign currency subsidiaries and associates into its reporting currency, sterling. The Group's primary balance sheet translation exposures are to the US dollar, Canadian dollar, euro, Danish krone, Turkish lira, South African rand, Russian rouble, Brazilian real and Australian dollar. These exposures are kept under continuous review. The Group's policy on borrowings is to broadly match the currency of these borrowings with the currency of cash flows arising from the Group's underlying operations. Within this overall policy, the Group aims to minimise all balance sheet translation exposure where it is practicable and cost-effective to do so through matching currency assets with currency borrowings. The main objective of these policies is to protect shareholder value by increasing certainty and minimising volatility in earnings per share. At 31 December 2010, the currency profile of the Group's gross debt, after taking into account derivative contracts, was 13 per cent (2009: 11 per cent) US dollar, 47 per cent (2009: 54 per cent) euro, 3 per cent (2009: 4 per cent) Canadian dollar, 11 per cent (2009: 6 per cent) sterling, 10 per cent (2009: 8 per cent) Australian dollar and 16 per cent (2009: 17 per cent) other currencies.

The Group faces currency exposures arising from the translation of profits earned in foreign currency subsidiaries and associates and joint ventures; these exposures are not normally hedged. Exposures also arise from:

(i) foreign currency denominated trading transactions undertaken by subsidiaries. These exposures comprise committed and highly probable forecast sales and purchases, which are offset wherever possible. The remaining exposures are hedged within the Treasury policies and procedures with forward foreign exchange contracts and options, which are designated as hedges of the foreign exchange risk of the identified future transactions; and

(ii) forecast dividend flows from subsidiaries to the centre. To ensure cash flow certainty, the Group hedges such flows using forward foreign exchange contracts designated as net investment hedges of the foreign exchange risk arising from the investments in these subsidiaries.

Notes on the accounts (continued)

24 Financial instruments continued

IFRS 7 requires a sensitivity analysis that shows the impact on the income statement and on items recognised directly in other comprehensive income of hypothetical changes of exchange rates in respect of non-functional currency financial assets and liabilities held across the Group. All other variables are held constant although, in practice, market rates rarely change in isolation. Financial assets and liabilities held in the functional currency of the Group's subsidiaries, as well as non-financial assets and liabilities and translation risk, are not included in the analysis. The Group considers a 10 per cent strengthening or weakening of the functional currency against the non-functional currency of its subsidiaries as a reasonably possible change. The impact is calculated with reference to the financial asset or liability held as at the year end, unless this is unrepresentative of the position during the year.

A 10 per cent strengthening of functional currencies against non-functional currencies would result in pre-tax profit being £36 million higher (2009: £24 million lower) and items recognised directly in other comprehensive income being £273 million higher (2009: £268 million higher). A 10 per cent weakening of functional currencies against non-functional currencies would result in pre-tax profit being £44 million lower (2009: £26 million higher) and items recognised directly in other comprehensive income being £333 million lower (2009: £328 million lower).

The exchange sensitivities on items recognised directly in other comprehensive income relate to hedging of certain net asset currency positions in the Group, but does not include sensitivities in respect of exchange on non-financial assets, as well as on cash flow hedges in respect of future transactions debt.

Interest rate risk

The objectives of the Group's interest rate risk management policy are to lessen the impact of adverse interest rate movements on the earnings, cash flow and economic value of the Group and to safeguard against any possible breach of its financial covenants. Additional objectives are to minimise the cost of hedging and the associated counterparty risk.

The Group targets an interest cover ratio, as calculated under its key central banking facilities, of greater than 5 and for 2010 it is 11.2 times (2009: 9.9 times). The only externally imposed capital requirement the Group has is in respect of its centrally managed banking facilities, which require a gross interest cover of 4.5.

In order to manage its interest rate risk, the Group maintains both floating rate and fixed rate debt. The Group sets targets (within overall guidelines) for the desired ratio of floating to fixed rate debt on both a gross and net basis (at least 50 per cent fixed on a net basis in the short to the medium-term) as a result of regular reviews of market conditions and strategy by the Corporate Finance Committee and the board of the main central finance company. At 31 December 2010, the relevant ratios of floating to fixed rate borrowings were 33:67 (2009: 48:52) on a gross basis and 9:91 (2009: 30:70) on a net basis. Underlying borrowings are arranged on both a fixed rate and a floating rate basis and, where appropriate, the Group uses derivatives, primarily interest rate swaps, to vary the fixed and floating mix. The interest rate profile of liquid assets is taken into account in determining the net interest rate exposure.

IFRS 7 requires a sensitivity analysis that shows the impact on the income statement and on items recognised directly in other comprehensive income of hypothetical changes of interest rates in respect of financial assets and liabilities of the Group. All other variables are held constant although, in practice, market rates rarely change in isolation. For the purposes of this sensitivity analysis, financial assets and liabilities with fixed interest rates are not included. The Group considers a 100 basis point change in interest rates a reasonably possible change except where rates are less than 100 basis points. In these instances it is assumed that the interest rates increase by 100 basis points and decrease to zero for the purpose of performing the sensitivity analysis. The impact is calculated with reference to the financial asset or liability held as at the year end, unless this is unrepresentative of the position during the year.

A 100 basis point increase in interest rates would result in pre-tax profit being £12 million lower (2009: £35 million lower). A 100 basis point decrease in interest rates, or less where applicable, would result in pre-tax profit being £8 million higher (2009: £34 million higher). The effect of these interest rate changes on items recognised directly in other comprehensive income is not material in either year.

Credit risk

The Group has no significant concentrations of customer credit risk. Subsidiaries have policies in place requiring appropriate credit checks on potential customers before sales commence. The process for monitoring and managing credit risk once sales to customers have been made varies depending on local practice in the countries concerned.

Certain territories have bank guarantees, other guarantees and credit insurance provided in the Group's favour in respect of Group trade receivables, the issuance and terms of which are dependent on local practices in the countries concerned.

All derivatives are subject to ISDA agreements or equivalent documentation.

Cash deposits and other financial instruments give rise to credit risk on the amounts due from the related counterparties. Generally the Group targets a long-term counterparty credit rating of at least A/A2. However the Group recognises that due to the need to operate over a large geographic footprint, sovereign risk can be the determining factor on the suitability of a counterparty. From time to time the Group may invest in short-dated corporate commercial paper and for this, the Group identifies specific counterparties with a minimum short-term rating of A1/P1.

Counterparty credit risk is managed on a global basis by limiting the aggregate amount and duration of exposure to any one counterparty, taking into account its credit rating. The credit ratings of all counterparties are reviewed regularly.

24 Financial instruments continued

The Group ensures that it has sufficient counterparty credit capacity of requisite quality to undertake all anticipated transactions throughout its geographic footprint, while at the same time ensuring that there is no geographic concentration in the location of counterparties.

The maximum exposure to the credit risk of financial assets at the balance sheet date is reflected by the carrying values included in the Group's balance sheet. In addition, the Group has issued guarantees to third parties, part of which has been recognised on the balance sheet in accordance with IAS 39. The unrecognised portion of these guarantees amounts to £64 million (2009: £84 million).

Price risk

The Group is exposed to equity price risk on equity investments held by the Group, which are included in available-for-sale investments on the Group balance sheet, but the quantum of such is not material.

Hedge accounting

In order to qualify for hedge accounting, the Group is required to document prospectively the relationship between the item being hedged and the hedging instrument. The Group is also required to demonstrate an assessment of the relationship between the hedged item and the hedging instrument, which shows that the hedge will be highly effective on an ongoing basis. This effectiveness testing is reperformed periodically to ensure that the hedge has remained, and is expected to remain highly effective.

Fair value estimation

The fair values of financial assets and liabilities with maturities of less than one year, other than derivatives, are assumed to approximate their book values. For other financial instruments which are measured at fair value in the balance sheet, the basis for fair values is described below.

Fair value hierarchy

The following table presents the Group's financial assets and liabilities that are measured at fair value in accordance with the IFRS 7 classification hierarchy:

				2010
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Assets at fair value				
Available-for-sale investments (note 15)	6	55	26	87
Derivatives relating to				
– interest rate swaps (note 16)		139		139
– cross-currency swaps (note 16)		16		16
– forward foreign currency contracts (note 16)		109		109
– others (note 16)	4	5		9
Assets at fair value	10	324	26	360
Liabilities at fair value				
Derivatives relating to				
– interest rate swaps (note 16)		8		8
– cross-currency swaps (note 16)		51		51
– forward foreign currency contracts (note 16)		248		248
– others (note 16)		12		12
Liabilities at fair value		319		319

				2009
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Assets at fair value				
Available-for-sale investments (note 15)	5	54	24	83
– interest rate swaps (note 16)		108		108
– cross-currency swaps (note 16)		15		15
– forward foreign currency contracts (note 16)		118		118
– others (note 16)	4	4		8
Assets at fair value	9	299	24	332
Liabilities at fair value				
– interest rate swaps (note 16)		1		1
– cross-currency swaps (note 16)		79		79
– forward foreign currency contracts (note 16)		127		127
– others (note 16)		14		14
Liabilities at fair value		221		221

Notes on the accounts (continued)

24 Financial instruments continued

Level 1 financial instruments are traded in an active market and fair value is based on quoted prices at the year end. This category includes listed equity shares of £9 million (2009: £8 million).

Level 2 financial instruments are not traded in an active market but the fair values are based on quoted market prices, broker dealer quotations, or alternative pricing sources with reasonable levels of price transparency. Level 2 financial instruments include certain money market securities and most OTC derivatives.

The fair values of level 3 financial instruments have been determined using a valuation technique where at least one input (which could have a significant effect on the instrument's valuation) is not based on observable market data. Level 3 financial instruments primarily consist of an equity investment in an unquoted entity which is valued using the discounted cash flows of estimated future dividends. The valuation assumes the following:

- future dividends grow by 2 per cent (2009: 2 per cent) and a 100 basis points decrease in the growth rate would result in the valuation being £2 million lower (2009: £2 million lower); and
- discount rate of 8 per cent (2009: 8 per cent) and a 100 basis points decrease in the discount rate would result in the valuation being £4 million higher (2009: £4 million higher).

The following table presents the changes in level 3 financial instruments:

	Available-for-sale investments	
	2010 £m	2009 £m
Beginning of year	**24**	24
Gains included in other comprehensive income	**3**	2
Differences on exchange	**(1)**	(2)
End of year	**26**	24

25 Cash flow

Cash generated from operations

	2010 £m	2009 £m
Profit from operations	**4,318**	4,101
Adjustments for		
– amortisation and impairment of trademarks	**106**	58
– amortisation and impairment of other intangible assets	**322**	120
– gains on disposal of businesses and trademarks	**(5)**	(2)
– depreciation and impairment of property, plant and equipment	**469**	433
– increase in inventories	**(280)**	(125)
– (increase) / decrease in trade and other receivables	**(127)**	30
– increase in trade and other payables	**497**	174
– decrease in net retirement benefit liabilities	**(153)**	(127)
– increase / (decrease) in provisions for liabilities and charges	**17**	(38)
– other non-cash items	**43**	21
Cash generated from operations	**5,207**	4,645

Profit from operations includes charges in respect of Group restructuring and integration costs referred to in note 3(e). These are also reflected in the movements in depreciation, amortisation, impairment, inventories, receivables, payables and provisions above and in the proceeds of disposal of property, plant and equipment shown in the Group cash flow statement. The net cash outflow in respect of the Group's restructuring costs was £193 million (2009: £173 million), of which £219 million (2009: £187 million) is included in cash generated from operations above.

25 Cash flow continued

Cash flows from investing activities

(a) Purchases and proceeds on disposals of investments
The purchases and disposals of investments (which comprise available-for-sale investments and loans and receivables) comprises a net cash outflow in respect of current investments of £1 million (2009: £37 million inflow).

(b) Purchase of Bentoel
In 2009, the net cash outflow of £370 million on the purchase of Bentoel reflects the settlement of the purchase consideration for an initial 85 per cent stake followed by the acquisition of a further 14 per cent from non-controlling interests, together with related acquisition costs and the acquired cash and cash equivalents and overdrafts.

(c) Purchase of Tekel cigarette assets
The £12 million outflow in 2009 in respect of the acquisition of Tekel cigarette assets reflected the final payment made at the conclusion of the acquisition.

(d) Proceeds from ST trademark disposals
The cash inflow in 2009 reflects proceeds of £188 million from the disposal of a small number of ST trademarks in Norway, the payment of the related disposal costs of £3 million and a £2 million refund of the original purchase price.

(e) Purchases of other subsidiaries and associates
In 2009, the £1 million outflow principally arises from equity investments in associate companies.

(f) Proceeds on disposal of subsidiaries
The proceeds on disposal of subsidiaries reflects the consideration received, less cash and cash equivalents disposed of, from the sale of the Group's Belgian distribution business, Lyfra NV, as explained in note 26(a).

Cash flows from financing activities

(a) Purchase of non-controlling interests
The cash outflow of £12 million in 2010 arises from the acquisition of non-controlling interests in Bentoel of shareholders who did not wish to participate in the merger of Bentoel and BAT Indonesia as well as non-controlling interests in subsidiaries in the Eastern Europe region.

As a result of the revision to IAS 27, the purchase of non-controlling interests is now classified under IAS 7 as a financing activity. This change is applied prospectively from 1 January 2010.

(b) Cash flows from borrowings
In May 2010, the Group repaid a €525 million bond. The repayment was financed from debt issued in November 2009.

On 25 June 2010, the terms of €470 million of the €1 billion bond maturing in 2011 were modified by extending the maturity to 2020; at the same time, the Group issued an additional €130 million bond with a maturity of 2020. In addition, €413 million of the Group's €750 million bond maturing in 2012 was purchased and cancelled. At the same time, the Group issued a new £275 million bond with a maturity of 2040.

During the year the Group's subsidiary in Brazil received proceeds of £410 million (2009: £293 million) from short-term borrowings in respect of advance payments on leaf export contracts and repaid £297 million (2009: £241 million).

During 2009, the Group had re-established its euro commercial paper programme (ECP). However, the ECP programme was undrawn at 31 December 2010 whereas, at 31 December 2009 £187 million of ECP was outstanding.

In February 2009, the Group repaid a €900 million bond which was financed by bond issues during 2008 and cash generated from operations.

In May 2009, the Group repaid Malaysian ringgit (MYR) 100 million which was refinanced in August 2009 by a new MYR250 million bond, due 2014. The additional proceeds were used to repay MYR150 million in November 2009. During June 2009, the Group also issued a new £250 million bond maturing in June 2022.

In September 2009 and October 2009, the Group repaid its €359 million and €759 million credit facilities used to finance the acquisition of Tekel in 2008. The €759 million was refinanced by a new €700 million term loan facility with a maturity date of 31 October 2012 with an option to extend it to October 2013, at the discretion of the banking participants in the syndicated facility. In December 2010, the €700 million term loan facility was partly repaid and the remaining term loan facility of €450 million was extended to October 2013 with the Group able to negotiate improved pricing.

In November 2009, the terms of €481 million of the €1 billion bond maturing in 2013 were modified by extending the maturity to 2021. At the same time, the Group issued an additional €169 million bond with a maturity of 2021. In addition, £199 million of the £350 million bond maturing in 2013 was purchased and cancelled; at the same time the Group issued a new £500 million bond with a maturity of 2034.

Notes on the accounts (continued)

25 Cash flow continued

(c) Derivative financial instruments
The movement relating to derivative financial instruments is in respect of derivatives taken out to hedge cash and cash equivalents and external borrowings, derivatives taken out to hedge inter company loans and borrowings and derivatives treated as net investment hedges. Derivatives taken out as cash flow hedges in respect of financing activities are also included in the movement relating to derivative financial instruments, while other such derivatives in respect of operating and investing activities are reflected along with the underlying transactions.

26 Business combinations and disposals

(a) Lyfra NV
On 7 April 2010, the Group announced that it had agreed to sell its Belgium distribution business, Lyfra NV, to Landewyck Group S.a.r.l. The transaction was completed on 25 June 2010 for a consideration of €16 million and resulted in a gain of £5 million. Lyfra contributed £215 million to revenue (£473 million for the year to 31 December 2009) and £1 million to profit from operations to 25 June 2010 (£1 million for the year to 31 December 2009) in the Western Europe Region.

(b) PT Bentoel Internasional Investama Tbk
On 17 June 2009, the Group acquired from PT Rajawali Corpora and other shareholders an 85 per cent stake in Indonesia's fourth largest cigarette maker PT Bentoel Internasional Investama Tbk (Bentoel) for US$494 million (£303 million). A public tender offer for the remaining shares was completed on 26 August 2009, resulting in the acquisition of a further 14 per cent share in the company, for IDR855,783 million (£52 million), bringing the total shareholding in the Bentoel Group to 99.7 per cent. This transaction resulted in goodwill of £188 million.

On 20 October 2009, it was announced that Bentoel and BAT Indonesia would enter into a merger plan whereby BAT Indonesia would merge into Bentoel. This was completed with an effective date of 1 January 2010. The Bentoel name has been retained and the company remains listed on the Indonesian Stock Exchange. As part of the merger, certain non-controlling interests were acquired for £3 million and the total shareholding in the merged group is 99.14 per cent.

(c) Items classified as held-for-sale
At 31 December 2010, held-for-sale assets comprise mainly land and buildings in Turkey and Canada which are being actively marketed for sale. At 31 December 2009, the external assets and liabilities of Lyfra NV comprising £12 million of inventories, £2 million of current trade and other receivables and £16 million of current trade and other payables were presented as held-for-sale. The remainder of held-for-sale assets at 31 December 2009 comprised plant, property and equipment of £3 million.

27 Share-based payments

During the period ended 31 December 2010, the following material share-based payment arrangements existed, which are described below:

Type of arrangement	Long-Term Incentive Plan	Deferred Share Bonus Scheme	Sharesave Scheme	Share Option Scheme	Share Reward Scheme
Timing of grant	Annually in March	Annually in March	See note (a)	See note (b)	Annually in April
Number of options/ shares granted in 2010	2,655,631	2,281,867	n/a	n/a	155,654
Number of options/ shares granted in 2009	3,809,739	3,567,941	3 year – 104,361 5 year – 115,004	n/a	253,678
Fair value per share for 2010 grant	£15.62	£19.78	n/a	n/a	£22.78
Fair value per share for 2009 grant	£11.00	£13.47	3 year – £3.89 5 year – £4.15	n/a	£16.07
Method of settlement	Both equity and cash-settled grants	Both equity and cash-settled grants	Equity	Both equity and cash-settled grants	Equity
Contractual life	10 years	3 years	3.5 or 5.5 years	10 years	3 years
Vesting conditions	See note (c)	See note (d)	See note (e)	See note (f)	See note (g)

Notes:

(a) In 2009, grants under the Sharesave Scheme were made in November. The Rules of the Scheme stipulate that Sharesave grants may be made within 42 days of a financial announcement. The Interim Management Statements reported by the Group for its results to 31 March and 30 September are not deemed to be financial announcements for the Rules of the Scheme and accordingly no grant has been made in November of the current year. The next grant date will be in March 2011.

(b) The granting of options under this scheme ceased with the last grant made in March 2004. Eligible individuals are entitled to participate in the Long-Term Incentive Plan and Deferred Share Bonus Scheme.

(c) Nil-cost options exercisable three years from date of grant, with payout subject to performance conditions based on earnings per share relative to inflation (50 per cent of grant) and total shareholder return, combining the share price and dividend performance of the Company by reference to two comparator groups (50 per cent of grant). Participants are not entitled to dividends prior to the exercise of the options. For grants made in 2005 and thereafter, a cash equivalent dividend will accrue through the vesting period and will be paid on vesting.

(d) Free shares released three years from date of grant and may be subject to forfeit if participant leaves employment before the end of the three year holding period. Participants receive a separate payment equivalent to a proportion of the dividend during the holding period.

(e) Options granted by invitation at a 20 per cent discount to the market price. Options are exercisable at the end of a three year or five year savings contract. Participants are not entitled to dividends prior to the exercise of the options. The maximum amount that can be saved by a participant in this way is £3,000 in any tax year.

(f) Options exercisable three years from date of grant and subject to earnings per share performance condition relative to inflation. Participants are not entitled to receive dividends in the period prior to the exercise of the options.

(g) Free shares granted (maximum £3,000 in any year) subject to a three year holding period and may be subject to forfeit if the employee leaves within this period. Participants are entitled to receive dividends during the holding period which are reinvested to buy further shares.

During the period, the Company operated a Partnership Share Scheme, which was open to all eligible employees, where employees can allocate part of their pre-tax salary to purchase shares in British American Tobacco p.l.c. The maximum amount that can be allocated in this way to any individual is £1,500 in any tax year. The shares purchased are held in a UK-based trust and are normally capable of transfer to participants tax free after a five year holding period.

Further details on the operation of share-based payment arrangements can be found in the Remuneration Report.

Notes on the accounts (continued)

27 Share-based payments continued

Share option schemes

Details of the movements for equity-settled share option schemes during the years ended 31 December 2010 and 31 December 2009 covering the Share Option and Sharesave Schemes were as follows:

	2010 Number of options	2010 Weighted average exercise price per share £	2009 Number of options	2009 Weighted average exercise price per share £
Outstanding at start of year	**2,435,584**	**9.55**	3,289,947	8.34
Granted during the period			219,365	15.55
Exercised during the period	**(869,236)**	**7.06**	(1,016,568)	7.60
Forfeited during the period	**(54,769)**	**12.70**	(57,160)	12.72
Outstanding at end of year	**1,511,579**	**10.87**	2,435,584	9.55
Exercisable at end of year	**629,598**	**7.13**	1,203,109	6.79

In addition to the above options, the movement in nil-cost equity-settled options from the Long-Term Incentive Plan was as follows:

	2010 Number of options	2009 Number of options
Outstanding at start of year	**7,559,620**	6,712,197
Granted during the period	**2,383,433**	3,451,451
Exercised during the period	**(2,201,780)**	(2,271,963)
Forfeited during the period	**(449,008)**	(330,835)
Changed to cash-settled share-based payment arrangement*		(1,230)
Outstanding at end of year	**7,292,265**	7,559,620
Exercisable at end of year	**391,775**	619,141

* During 2010, equity-settled awards in respect of nil (2009: 1,230) options were modified to a cash-settled basis.

The weighted average British American Tobacco p.l.c. share price at the date of exercise for share options exercised during the period was £22.27 (2009: £17.58). A detailed breakdown of the range of exercise prices for options outstanding for the years ended 31 December 2010 and 31 December 2009 is shown in the table below:

Range of exercise prices	2010 Number outstanding at end of year	2010 Weighted average remaining contractual life in years	2010 Weighted average exercise price per share £	2009 Number outstanding at end of year	2009 Weighted average remaining contractual life in years	2009 Weighted average exercise price per share £
Nil-cost	**7,292,265**	**8.2**	**n/a**	7,559,620	8.2	n/a
£2.53 to £4.99		**n/a**	**n/a**	60,672	0.2	2.54
£5.00 to £6.99	**301,069**	**1.8**	**6.09**	815,533	2.1	6.22
£7.00 to £8.99	**328,529**	**3.3**	**8.09**	532,909	4.2	8.09
£9.00 to £12.49	**208,288**	**0.9**	**10.67**	306,281	1.6	10.93
£12.50 to £15.99	**673,693**	**2.6**	**14.42**	720,189	3.6	14.41
	8,803,844	**7.2**	**1.87**	9,995,204	6.9	2.33

The weighted average fair value of equity-settled share option schemes shares granted during 2010 was £15.62 (2009: £10.58).

27 Share-based payments continued

Assumptions used in the Black-Scholes models to determine the fair value of share options at grant date were as follows:

	2010 Long-Term Incentive Plan	2010 Sharesave Schemes*	2009 Long-Term Incentive Plan	2009 Sharesave Schemes**
Share price at date of grant (£)	**22.58**	**n/a**	15.79	19.43
Exercise price (£)	**nil-cost**	**n/a**	nil-cost	15.55
Volatility (%)	**25**	**n/a**	24	25
Average expected term to exercise (years)	**3.5**	**n/a**	3.5	3.2/5.2
Risk-free rate (%)	**2.1**	**n/a**	2.1	1.6/2.6
Expected dividend yield (%)	**4.4**	**n/a**	5.3	4.6

* No Sharesave Scheme grants were awarded in 2010, as explained in note 27(a).
** Where two figures have been quoted for the Sharesave Schemes, the first number represents the assumptions for the three-year savings contract and the second number for the five-year savings contract.

Market condition features were incorporated into the Monte-Carlo models for the total shareholder return elements of the Long-Term Incentive Plan, in determining fair value at grant date. Assumptions used in these models were as follows:

	2010	2009
Average share price volatility FTSE 100 comparator group	**38**	35
Average share price volatility FMCG comparator group	**25**	24
Average correlation FTSE 100 comparator group	**37**	38
Average correlation FMCG comparator group	**33**	32

The expected British American Tobacco p.l.c. share price volatility was determined taking account of the daily share price movements over a five year period. The respective FMCG and FTSE 100 share price volatility and correlations were also determined over the same periods. The average expected term to exercise used in the models has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions and behavioural conditions, forfeiture and historical experience.

The risk-free rate has been determined from market yield curves for government gilts with outstanding terms equal to the average expected term to exercise for each relevant grant. The expected dividend yield was determined by calculating the yield from the last two declared dividends divided by the grant share price.

For grants containing earnings per share performance conditions, the payout calculation is based on the expectations published in analysts' forecasts.

Other equity share-based payment arrangements (other than share options)

Details of the movements of other equity share-based payment arrangements during the years ended 31 December 2010 and 31 December 2009, covering the Deferred Share Bonus and Share Reward Schemes, were as follows:

	2010 Number of shares	2009 Number of shares
Outstanding at start of year	**6,481,964**	5,069,083
Granted during the period	**2,116,406**	3,326,759
Exercised during the period	**(2,386,182)**	(1,847,581)
Forfeited during the period	**(36,913)**	(57,921)
Changed to cash-settled share-based payment arrangement*		(8,376)
Outstanding at end of year	**6,175,275**	6,481,964
Exercisable at end of year	**216,737**	240,408

* In 2009, equity-settled awards in respect of 8,376 shares were modified to a cash-settled basis.

The shares outstanding for the year ended 31 December 2010 had a weighted average contractual life of 1.3 years (2009: 1.4 years).

Notes on the accounts (continued)

27 Share-based payments continued

The fair value for other equity share-based payment arrangements granted during the period was determined using the Black-Scholes model with the following input assumptions at their grant date:

	2010		2009	
	Deferred Share Bonus Scheme	Share Reward Scheme	Deferred Share Bonus Scheme	Share Reward Scheme
Grant price (£)	22.58	22.79	15.79	16.07
Expected volatility (%)	25	25	24	24
Average expected term to exercise (years)	3.0	5.0	3.0	5.0
Risk-free rate (%)	1.8	2.8	2.0	2.3
Expected dividend yield (%)	4.4	4.4	5.3	5.2

The weighted average fair value of other equity share-based payment arrangements granted during 2010 was £19.98 (2009: £13.67).

Cash-settled share-based payment arrangements

The Group issues to certain employees cash-settled share-based payments that require the Group to pay the intrinsic value of these share-based payments to the employee at the date of exercise. The Group has recorded liabilities at the end of 2010 of £27.2million (2009: £25.7 million) of which £3.7 million (2009: £5.7 million) was in respect of vested grants. Fair value was determined from the Black-Scholes and Monte-Carlo models, using assumptions revised at the balance sheet date for cash-settled share-based payment arrangements. The Group recorded total expenses of £20.2 million in 2010 (2009: £14.0 million).

Details of movements for cash-settled arrangements in respect of the Share Option Scheme during the years ended 31 December 2010 and 31 December 2009, were as follows:

	2010		2009	
	Number of options	Weighted average exercise price per share £	Number of options	Weighted average exercise price per share £
Outstanding at start of year	110,076	6.85	213,189	6.51
Granted during the period	n/a	n/a	n/a	n/a
Exercised during the period	(49,994)	6.42	(103,113)	6.15
Outstanding at end of year	60,082	7.21	110,076	6.85
Exercisable at end of year	60,082	7.21	110,076	6.85

In addition to the above, the movement in other nil-cost cash-settled arrangements during the years ended 31 December 2010 and 31 December 2009, covering the Long-Term Incentive Plan and Deferred Share Bonus Scheme, was as follows:

	2010 Number of shares	2009 Number of shares
Outstanding at start of year	2,193,023	2,015,771
Granted during the period	593,313	853,148
Exercised during the period	(829,730)	(644,496)
Forfeited during the period	(85,095)	(41,006)
Changed from equity-settled share-based arrangement*		9,606
Outstanding at end of year	1,871,511	2,193,023
Exercisable at end of year	106,934	209,736

* As explained in the sections for Share Option Schemes and Other equity share-based payment arrangements, in 2009, 9,606 awards in respect of shares were changed from an equity-settled to a cash-settled basis.

Assumptions used to determine the fair value of cash-settled share-based payment arrangements at date of grant, can be found in the sections relating to share option schemes and other equity share-based payment arrangements.

27 Share-based payments continued

The weighted average British American Tobacco p.l.c. share price at the date of exercise for cash-settled share-based arrangements exercised during the period was £22.53 (2009: £17.17). A detailed breakdown of the range of exercise prices for cash-settled share-based payment arrangements outstanding for the years ended 31 December 2010 and 31 December 2009 are shown in the table below:

			2010			2009
Range of exercise prices	Number outstanding at end of year	Weighted average remaining contractual life in years	Weighted average exercise price per share £	Number outstanding at end of year	Weighted average remaining contractual life in years	Weighted average exercise price per share £
Nil-cost	**1,871,511**	**4.6**	**n/a**	2,193,023	5.9	n/a
£5.60 to £5.98	**25,176**	**2.3**	**5.98**	51,281	3.2	5.98
£6.39 to £8.09	**34,906**	**1.9**	**6.96**	58,795	3.1	6.93
	1,931,593	**4.6**	**0.20**	2,303,099	5.6	0.54

Share-based payment expense

The amounts recognised in the income statement in respect of share-based payments were as follows:

	2010 £m	2009 £m
Equity-settled share-based payments	**67**	61
Cash-settled share-based payments	**20**	14
Total amount recognised in the income statement (note 3(a))	**87**	75

28 Group employees

The average number of persons employed by the Group and its associates during the year, including Directors, was 92,285 (2009: 97,078).

	2010 Number	2009 Number
Asia-Pacific	**15,848**	16,414
Americas	**16,423**	16,626
Western Europe	**14,476**	14,785
Eastern Europe	**6,828**	7,568
Africa and Middle East	**6,856**	7,028
Subsidiary undertakings	**60,431**	62,421
Associates	**31,854**	34,657
	92,285	97,078

Details of Directors' remuneration, share options and retirement benefits are given in the Remuneration report.

Included within the employee numbers for Europe are certain employees in the UK in respect of central functions. Some of the costs of these employees are allocated or charged to the various regions and markets in the Group.

Notes on the accounts (continued)

29 Related party disclosures

The Group has a number of transactions and relationships with related parties, as defined in IAS 24 (Related Party Disclosures), all of which are undertaken in the normal course of business.

Transactions and balances with associates relate mainly to the sale and purchase of cigarettes and tobacco leaf. Amounts receivable from associates in respect of dividends included in the table below were £77 million (2009: £68 million). The Group's share of dividends from associates was £466 million (2009: £331 million). Legal fees recovered from Reynolds American Inc. included in other net income amounted to £1 million (2009: £nil).

	2010 £m	2009 £m
Transactions		
– revenue	**38**	47
– purchases	**(442)**	(365)
– other net income	**460**	329
Amounts receivable at 31 December	**99**	78
Amounts payable at 31 December	**(21)**	(34)

On 26 May 2010, a wholly-owned subsidiary of the Group, BATUS Japan Inc., entered into an American blend Cigarette Manufacturing Agreement (referred to as the 2010 Agreement) with a wholly-owned subsidiary of Reynolds American, R.J. Reynolds Tobacco Company (referred to as RJRTC), with an effective date of 1 January 2010. Under this Agreement, RJRTC has been appointed as BATUS Japan's exclusive manufacturer of all BATUS Japan's requirements for certain American-blend cigarettes intended to be distributed and sold in Japan for the five year period expiring on 31 December 2014, subject to the early termination and extension provisions set out in the agreement. The 2010 Agreement is based on arm's length terms and conditions.

On the same date, RJRTC and BATUS Japan entered into a letter agreement terminating the existing Contract Manufacturing Agreement dated 30 July 2004 (referred to as the 2004 Agreement), as amended between the parties, with effect from midnight on 31 December 2009. The 2004 Agreement was scheduled to expire on 31 December 2014, subject to early termination and extension provisions. Under the terms of the letter agreement, certain sections and sub-sections of the 2004 Agreement will survive the termination, and, in consideration for RJRTC agreeing to terminate the agreement and in settlement of all disputes at issue between the parties, BATUS Japan agreed to pay RJRTC US$21 million. The payment has been presented as an adjusting item and is included within the Group's restructuring and integration costs in note 3(e). The Group's share of the income net of tax included within the post-tax results of Reynolds American is also presented as an adjusting item and is credited against restructuring costs (see note 5).

In 2010, the Group acquired non-controlling interests of shareholders in Indonesia and Eastern Europe for £3 million (see note 26) and £9 million respectively. These transactions are shown as a £12 million reduction to reserves in note 20.

As explained in note 26(a), the Group sold its Belgian distribution business, Lyfra NV, to Landewyck Group S.a.r.l. in 2010 for a consideration of €16 million. The Group's German subsidiary has an available-for-sale investment in Landewyck Group S.a.r.l.

In 2009, a capital injection was made into BAT Algeria where a shareholder SOCALTA (Societé Algerienne de Trading Alimentaire) contributed £16 million as shown in note 20. This contribution by a non-controlling interest was assisted by a loan from another Group subsidiary of £4 million.

The key management personnel of British American Tobacco consist of the members of the Board of Directors of British American Tobacco p.l.c. and the members of the Management Board. No such person had any material interest during the year in a contract of significance (other than a service contract) with the Company or any subsidiary company. The term key management personnel in this context includes the respective members of their households.

	2010 £m	2009 £m
The total compensation for key management personnel, including Directors, was:		
– salaries and other short-term employee benefits	**22**	18
– post-employment benefits	**3**	3
– share-based payments	**12**	9
	37	30

There were no other long-term benefits applicable in respect of key personnel other than those disclosed in the Remuneration report in the Annual Report.

30 Contingent liabilities and financial commitments

The Group is subject to contingencies pursuant to requirements that it complies with relevant laws, regulations and standards. Failure to comply could result in restrictions in operations, damages, fines, increased tax, increased cost of compliance, interest charges, reputational damage, or other sanctions. These matters are inherently difficult to quantify.

In cases where the Group has an obligation as a result of a past event existing at the balance sheet date, it is probable that an outflow of economic resources will be required to settle the obligation and the amount of the obligation can be reliably estimated, a provision would be recognised based on best estimates and management judgment.

There are, however, contingent liabilities in respect of litigation, taxes in some countries and guarantees for which no provisions were made.

The Group has exposures in respect of the payment or recovery of a number of taxes. The Group is and has been subject to a number of tax audits covering amongst others, excise tax, value added taxes, sales taxes, corporate taxes, withholding taxes and payroll taxes.

The estimated costs of known tax obligations have been provided in these accounts in accordance with the Group's accounting policies. In some countries, tax law requires that full or part payment of disputed tax assessments be made pending resolution of the dispute. To the extent that such payments exceed the estimated obligation, they would not be recognised as an expense. In some cases disputes are proceeding to litigation.

While the amounts that may be payable or receivable could be material to the results or cash flows of the Group in the period in which they are recognised, the Board does not expect these amounts to have a material effect on the Group's financial condition.

Product liability litigation

Group companies, notably Brown & Williamson Holdings, Inc. (formerly Brown & Williamson Tobacco Corporation) (B&W) as well as other leading cigarette manufacturers, are defendants, principally in the United States, in a number of product liability cases. In a number of these cases, the amounts of compensatory and punitive damages sought are significant.

Indemnity

In 2004, B&W completed the combination of the assets, liabilities and operations of its US tobacco business with R.J. Reynolds Tobacco Company (RJRT), a wholly-owned subsidiary of R.J. Reynolds Tobacco Holdings, Inc., pursuant to which Reynolds American Inc. was formed (the Business Combination). As part of the Business Combination, B&W contributed to RJRT all of the assets and liabilities of its US cigarette and tobacco business, subject to specified exceptions, in exchange for a 42 per cent equity ownership interest in Reynolds American Inc. As a result of the Business Combination:

- B&W discontinued the active conduct of any tobacco business in the United States;
- B&W contributed to RJRT all of its assets other than the capital stock of certain subsidiaries engaged in non-US businesses and other limited categories of assets;
- RJRT assumed all liabilities of B&W (except liabilities to the extent relating to businesses and assets not contributed by B&W to RJRT and other limited categories of liabilities) and contributed subsidiaries or otherwise to the extent related to B&W's tobacco business as conducted in the United States on or prior to 30 July 2004; and
- RJRT agreed to indemnify B&W and each of its associates (other than Reynolds American Inc. and its subsidiaries) against, among other matters, all losses, liabilities, damages, expenses, judgments, attorneys' fees, etc., to the extent relating to or arising from such assumed liabilities or the assets contributed by B&W to RJRT (the RJRT Indemnification).

The scope of the RJRT Indemnification includes all expenses and contingent liabilities in connection with litigation to the extent relating to or arising from B&W's US tobacco business as conducted on or prior to 30 July 2004, including smoking and health tobacco litigation, whether the litigation is commenced before or after 30 July 2004 (the Tobacco Litigation).

Pursuant to the terms of the RJRT Indemnification, RJRT is liable for any possible judgments, the posting of appeal bonds or security, and all other expenses of and responsibility for managing the defence of the Tobacco Litigation. RJRT has assumed control of the defence of the Tobacco Litigation involving B&W, to which RJRT is also a party in most (but not all) of the same cases. Accordingly, RJRT uses or plans to use the same law firm or firms to represent both B&W and RJRT in any single or similar case (except in certain limited circumstances) as RJRT's interests are typically aligned with B&W's interests, as RJRT has substantial experience in managing recognised external legal counsel in defending the Tobacco Litigation, and external counsel have independent professional responsibilities to represent the interests of B&W. In addition, in accordance with the terms of the RJRT Indemnification, associates of B&W have retained control of the defence in certain Tobacco Litigation cases with respect to which such associates are entitled to indemnification.

Included in the US litigation section below are all significant cases where B&W and/or a UK company is named as a defendant and all cases where RJRT is named as a defendant as a successor to B&W (the RJRT Successor Cases). The RJRT Successor Cases are covered by the indemnity explained above. Of the RJRT Successor Cases, the section below includes details of all cases where there has been an adverse judgment and also notes favourable judgments.

US litigation

The total number of US product liability cases pending at 31 December 2010 naming B&W was approximately 9,458 (2009: approximately 9,991). Of these, 6,303 cases are RJRT Successor Cases. For all of these cases, British American Tobacco Group companies have the protection of the indemnity above. British American Tobacco (Investments) Limited (Investments) has been served as a co-defendant in five of those cases (2009: six). No other UK based Group company has been served as a co-defendant in any US product liability case pending as at 31 December 2010. In 2010, there were no US product liability cases tried to verdict against B&W. No product liability case in which a UK-based Group company is a defendant was tried in 2010, and one case in which a UK-based Group company is a defendant started

Notes on the accounts (continued)

30 Contingent liabilities and financial commitments continued

trial in January 2011 (City of St. Louis – see below). Since many of these pending cases seek unspecified damages, it is not possible to quantify the total amounts being claimed, but the aggregate amounts involved in such litigation are significant, possibly totalling in the billions of US dollars. The cases fall into four broad categories:

(a) Medical reimbursement cases
These civil actions seek to recover amounts spent by government entities and other third party providers on healthcare and welfare costs claimed to result from illnesses associated with smoking. Although B&W continues to be a defendant in healthcare cost recovery cases involving plaintiffs such as hospitals and Native American tribes (see below), the vast majority of such cases have been dismissed on legal grounds.

Further, on 23 November 1998, the major US cigarette manufacturers (including B&W and RJRT) and the attorneys general of 46 US states and five US territories executed the Master Settlement Agreement (MSA), which settled medical reimbursement lawsuits that had been brought by these states and territories. Under the terms of the MSA, the settling cigarette manufacturers agreed, among other things, to pay approximately US$246 billion to the settling states and territories (and to four states that reached separate settlements of their medical reimbursement actions) over 25 years, and agreed to various restrictions on US tobacco advertising and marketing. The MSA includes a credit for any amounts paid by participating manufacturers in subsequent suits brought by the states' political subdivisions.

At 31 December 2010, three US medical reimbursement suits were pending against B&W (2009: two). One of these suits was brought by an Indian tribe in the Indian Tribal Court in South Dakota. Another reimbursement suit (City of St. Louis) is pending against B&W, Investments and several other defendants in the state court in Missouri. In City of St. Louis, the plaintiffs, approximately 40 public and non-profit hospitals in Missouri, are seeking reimbursement of past and future alleged smoking-related healthcare costs. On 26 October 2007, the plaintiffs filed a motion requesting the court to give collateral estoppel effect to the factual findings in the US Department of Justice case, which motion was denied on 2 June 2010. On 1 December 2009, certain defendants, including B&W and Investments, filed additional motions for summary judgment. In a series of orders issued from April 2010 through October 2010, the court granted summary judgment as to the plaintiffs' claims for fraudulent misrepresentation, negligent misrepresentation, failure to warn (whether sounding in strict liability or negligence) and improper marketing, and entered judgment in favour of the defendants, including B&W and Investments, on these claims. The court also dismissed the plaintiffs' claims for prejudgment interest, future damages, and damages allegedly arising out of exposure to environmental tobacco smoke (ETS), thus reducing the damages claims from the US$2 billion originally sought to approximately US$600 million. The claims remaining for trial are product defect (whether sounding in strict liability or negligence), restitution, civil conspiracy, aiding and abetting and punitive damages. The trial of this case began on 31 January 2011, and is expected to last approximately four to six months.

In another recoupment suit (National Committee to Preserve Social Security & Medicare), the plaintiffs, two taxpayer advocacy groups and a Medicare recipient diagnosed with lung cancer, alleged that the defendants (including B&W) are liable for the payment of Medicare beneficiaries' medical costs for diseases attributable to smoking, pursuant to the Medicare as Secondary Payer Statute (MSP). On 5 March 2009, the district court in the Eastern District of New York issued an order granting the defendants' motion to dismiss the plaintiffs' complaint in its entirety, and denying the plaintiffs' cross motion for summary judgment. The district court ruled that MSP plaintiffs can only recover Medicare funds where an alleged tortfeasor's liability has been established prior to the plaintiffs' seeking relief under the MSP, and that the plaintiffs in National Committee had failed to establish such liability. The plaintiffs filed a notice of appeal to the US Court of Appeals for the Second Circuit on 20 May 2009. On 4 February 2010, the defendants filed a motion to dismiss the appeal. On 23 June 2010, the Second Circuit denied the defendants' motion to dismiss the appeal. On 8 October 2010, a summary order was entered by the Second Circuit that vacated the judgment of the district court and remanded the case with instructions to dismiss the complaint for lack of subject matter jurisdiction. On 22 December 2010, the district court entered an order of dismissal for lack of subject matter jurisdiction and directed the Clerk of Court to enter judgment in accordance with the instructions from the Second Circuit. The Clerk of Court entered judgment in defendants' favour on 23 December 2010.

(b) Class actions
At 31 December 2010, B&W was named as a defendant in eight (2009: eight) separate actions attempting to assert claims on behalf of classes of persons allegedly injured or financially impacted through smoking or where classes of tobacco claimants have been certified. If the classes are or remain certified and the possibility of class-based liability is eventually established, it is likely that individual trials will be necessary to resolve any claims by individual plaintiffs. Class action suits have been filed in a number of states against individual cigarette manufacturers and their parent corporations, alleging that the use of the terms 'lights' and 'ultralights' constitutes unfair and deceptive trade practices.

The Schwab class-action complaint (Schwab) was filed in the US District Court for the Eastern District of New York on 11 May 2004 against several defendants, including B&W and certain UK-based Group companies. The complaint challenges the defendants' practices with respect to the marketing, advertising, promotion and sale of 'light' cigarettes. After six years of litigation, including before appellate courts, the parties on 13 July 2010 filed a stipulation of dismissal.

The Cleary class action complaint was filed in the state court in Chicago, Illinois on 3 June 1998 against several defendants, including B&W, B.A.T Industries p.l.c. (Industries) and Investments. Industries was dismissed on jurisdictional grounds by an intermediate appellate court on 17 March 2000. The Third Amended Complaint, filed on 3 March 2009, alleged that all defendants fraudulently concealed facts regarding the addictive nature of nicotine, that certain US defendants (but not Investments) marketed tobacco products to underage consumers, and that defendant Philip Morris fraudulently marketed Marlboro Lights cigarettes. The plaintiffs sought disgorgement

30 Contingent liabilities and financial commitments continued

of profits. The case was removed to the federal district court on 13 March 2009, and the federal district court denied the plaintiffs' motion to remand the case back to the state court via order dated 1 July 2009. On 1 February 2010, the court granted summary judgment dismissing the plaintiffs' fraudulent concealment claim, and permitted the plaintiffs to reinstate that claim via a new plaintiff. The court also granted summary judgment dismissing the plaintiffs' youth marketing claims and permitted the Marlboro Lights claim to proceed against defendant Philip Morris. On 22 February 2010, the court denied the plaintiffs' motion for class certification of all three putative classes, but granted the plaintiffs leave to reinstate the certification motion as to the putative class alleging the fraudulent concealment claim if the plaintiffs identified a new plaintiff to represent that putative class. On 18 April 2010, the plaintiffs filed a motion for leave to file a Fourth Amended Complaint, which was granted on 22 April 2010. The Fourth Amended Complaint alleged that all defendants fraudulently concealed facts regarding the addictive nature of nicotine, and that defendant Philip Morris fraudulently marketed Marlboro Lights cigarettes. The plaintiffs sought disgorgement of profits. On 7 May 2010, the defendants filed a motion to dismiss the plaintiffs' Fourth Amended Complaint, which motion was granted on 22 June 2010. On 20 August 2010, the plaintiffs filed a notice of appeal in the US Court of Appeals for the Seventh Circuit. Briefing on the plaintiffs' appeal commenced in December 2010 and is expected to conclude in February 2011.

In a medical monitoring class action brought on behalf of Louisiana smokers (Scott) the jury returned a verdict on 28 July 2003 in favour of the defendants on the plaintiffs' claim for medical monitoring and found that cigarettes were not defectively designed. However, the jury also made certain findings against the defendants on claims relating to fraud, conspiracy, marketing to minors and smoking cessation. Notwithstanding these findings, this portion of the trial did not determine liability as to any individual class member or class representative. On 21 May 2004, the jury returned a verdict in the amount of US$591 million, requiring the defendants to fund a cessation programme to help eligible class members stop smoking. On 29 September 2004, the defendants posted a US$50 million bond, pursuant to legislation that limits the amount of the bond to US$50 million collectively for MSA signatories, and noticed their appeal. RJRT posted US$25 million (the portions for RJRT and B&W) towards the bond. On 7 February 2007, the Louisiana Court of Appeals upheld the class certification and found the defendants responsible for funding smoking cessation for eligible class members. The appellate court also ruled, however, that no class member who began smoking after 1 September 1988 could receive any relief, and that only those smokers whose claims accrued on or before 1 September 1988 would be eligible for the smoking cessation programme. In addition, the appellate court rejected the award of prejudgment interest, and struck eight of the twelve components of the smoking cessation programme. The defendants' application to the Louisiana Supreme Court for a writ of certiorari was denied on 7 January 2008. The defendants' petition to the US Supreme Court for a writ of certiorari was denied on 10 June 2008. On 21 July 2008, the trial court entered an amended judgment in the case. The court found that the defendants are jointly and severally liable for funding the cost of a court-supervised smoking cessation program and ordered the defendants to deposit approximately US$263 million together with interest from 30 June 2004, into a trust for the funding of the programme. On 23 April 2010, the Louisiana Court of Appeals amended but largely affirmed the trial court's amended judgment. Pursuant to the judgment, the defendants are required to deposit US$242 million with the court, with interest from 21 July 2008 until paid. In September 2010, the defendants' application for writ of certiorari or review by the Supreme Court of Louisiana along with the defendants' motion to stay execution of the judgment was denied. On 24 September 2010, the US Supreme Court granted the defendants' motion to stay the judgment pending the US Supreme Court's disposition of the defendants' petition for a writ of certiorari, which was filed on 2 December 2010.

Black is a 'lights' class action filed in November 2000 in the Circuit Court, City of St. Louis, Missouri. B&W removed the case to the US District Court for the Eastern District of Missouri on 23 September 2005. On 25 October 2005, the plaintiffs filed a motion to remand, which was granted on 17 March 2006. On 16 April 2008, the court stayed the case pending US Supreme Court review in Good v. Altria Group, Inc. A nominal trial date of 10 January 2011 was scheduled, but trial did not proceed at that time. No new date has been set.

Brown is a case filed in June 1997 in the Superior Court, San Diego County, California. On 11 April 2001, the court granted in part the plaintiffs' motion for certification of a class composed of residents of California who smoked at least one of the defendants' cigarettes from 10 June 1993 through 23 April 2001, and who were exposed to the defendants' marketing and advertising activities in California. The plaintiffs seek to recover restitution, disgorgement of profits and other equitable relief under the California Business and Professions Code. Certification was granted as to the plaintiffs' claims that the defendants violated the section of the California Business and Professions Code pertaining to unfair competition. The court, however, refused to certify the class under the California Legal Remedies Act and on the plaintiffs' common law claims. On 7 March 2005, the court granted the defendants' motion to decertify the class. On 5 September 2006, the California Court of Appeal affirmed the judge's order decertifying the class. On 1 November 2006, the plaintiffs' petition for review with the California Supreme Court was granted. On 18 May 2009, the California Supreme Court reversed the decision issued by the trial court and affirmed by the California Court of Appeal that decertified the class to the extent that it was based upon the conclusion that all class members were required to demonstrate standing, and remanded the case to the trial court for further proceedings regarding whether the class representatives have, or can demonstrate, standing. On 10 March 2010, the California Superior Court found that the plaintiffs' 'lights' claims were not pre-empted by the Federal Cigarette Labelling and Advertising Act, rendered the court's 30 September 2004 ruling on the issue no longer viable, and denied the defendants' second motion for summary judgment. The plaintiffs filed a tenth amended complaint on 10 September 2010. Certain defendants, including RJRT and B&W, filed answers to the tenth amended complaint on 12 October 2010. Trial is scheduled to begin on 6 May 2011.

Notes on the accounts (continued)

30 Contingent liabilities and financial commitments continued

Howard is a 'lights' class action filed in February 2000 in the Circuit Court, Madison County, Illinois. A judge certified a class on 18 December 2001. On 6 June 2003, the trial judge issued an order staying all proceedings pending resolution of Price v. Philip Morris, Inc., a 'lights' class action against Philip Morris, Inc. in the Illinois state court. The plaintiffs appealed this stay order to the Illinois Fifth District Court of Appeals, which affirmed the Circuit Court's stay order on 19 August 2005. There is currently no activity in the case.

Jones is a case filed in December 1998 in the Circuit Court, Jackson County, Missouri. The defendants removed the case to the US District Court for the Western District of Missouri on 16 February 1999. The action was brought by tobacco product users and purchasers on behalf of all similarly situated Missouri consumers. The plaintiffs allege that their use of the defendants' tobacco products has caused them to become addicted to nicotine. The plaintiffs seek to recover an unspecified amount of compensatory and punitive damages. The case was remanded to the Circuit Court on 17 February 1999. There has been limited activity in this case.

Parsons is a case filed in February 1998 in the Circuit Court, Ohio County, West Virginia. The plaintiff sued asbestos manufacturers, US cigarette manufacturers, including B&W, among other defendants, seeking to recover US$1 million in compensatory and punitive damages individually and an unspecified amount for the class in both compensatory and punitive damages. The class was brought on behalf of persons who allegedly have personal injury claims arising from their exposure to respirable asbestos fibres and cigarette smoke. The case has been stayed pending a final resolution of the plaintiffs' motion to refer tobacco litigation to the judicial panel on multidistrict litigation filed in In Re: Tobacco Litigation in the Supreme Court of Appeals of West Virginia. On 26 December 2000, three defendants, Nitral Liquidators, Inc., Desseaux Corporation of North American and Armstrong World Industries, filed bankruptcy petitions in the US Bankruptcy Court for the District of Delaware. Pursuant to the Bankruptcy Code, Parsons is automatically stayed with respect to all defendants.

Young is a case filed in November 1997 in the Circuit Court, Orleans Parish, Louisiana. The plaintiffs brought an ETS class action on behalf of all residents of Louisiana who, though not themselves cigarette smokers, have been exposed to second-hand smoke from cigarettes which were manufactured by the defendants, and who allegedly suffered injury as a result of that exposure. The plaintiffs seek to recover an unspecified amount of compensatory and punitive damages. On 13 October 2004, the trial court stayed this case pending the outcome of appellate review in the Scott class action in Louisiana (discussed above).

In Engle (a case in Florida), a jury awarded a total of US$12.7 million to three class representatives, and in a later stage of the three-phase trial procedure adopted in this case, a jury assessed US$17.6 billion in punitive damages against B&W. On 21 May 2003, the intermediate appellate Court reversed the trial court's judgment and remanded the case to the trial court with instructions to de-certify the class. On 16 July 2003, the plaintiffs filed a motion for rehearing which was denied on 22 September 2003. On 12 May 2004, the Florida Supreme Court agreed to review this case and, on 6 July 2006, it upheld the intermediate appellate court's decision to decertify the class and vacated the jury's punitive damages verdict. Further, the Florida Supreme Court permitted the judgments entered for two of the three Engle class representatives to stand, but dismissed the judgment entered in favour of the third Engle class representative. Finally, the Florida Supreme Court has permitted putative Engle class members to file individual lawsuits against the Engle defendants within one year of the court's decision (subsequently extended to 11 January 2008). The court's order precludes defendants from litigating certain issues of liability against the putative Engle class members in these individual actions. On 7 August 2006, the defendants filed a motion for rehearing before the Florida Supreme Court, which was granted in part and denied in part, on 21 December 2006. The Florida Supreme Court's 21 December 2006 ruling did not amend any of the earlier decisions' major holdings, which included decertifying the class, vacating the punitive damages judgment, and permitting individual members of the former class to file separate suits. Instead, the ruling addressed the claims on which the Engle jury's phase one verdict will be applicable to the individual lawsuits that were permitted to stand. On 1 October 2007, the United States Supreme Court denied the defendants' request for certiorari review of the Florida Supreme Court's decision.

As at 31 December 2010, B&W have been served in approximately 49 Engle progeny cases in both state and federal courts in Florida. These cases include approximately 105 plaintiffs. RJRT as a successor to B&W are named in approximately 6,286 Engle progeny cases. The plaintiffs' counsel included multiple plaintiffs in most of the cases filed, so case totals have increased over the past year as Florida courts ordered cases originally filed as multi-plaintiff actions to be severed.

In the first 'phase three' trial of an individual Engle class member (Lukacs), the jury awarded the plaintiff US$37.5 million in compensatory damages (B&W's share: US$8.4 million) on 11 June 2002. On 1 April 2003, the jury award was reduced to US$25.1 million (B&W's share: US$5.6 million) but no final judgment was entered into because the trial court postponed the entry of final judgment until the Engle appeal was fully resolved. The trial court, on 14 August 2008, issued an order entering judgment for the plaintiff that awarded US$24.8 million to the plaintiff (plus interest), for which the defendants would be jointly and severally liable. On 17 October 2008, the plaintiff withdrew her request for punitive damages. On 12 November 2008, the trial court entered final judgment. On 1 December 2008, the defendants filed a notice of appeal. On 17 March 2010, the Third District Court of Appeal affirmed the ruling of the trial court. The defendants' motion for rehearing and petition for rehearing en banc was denied on 18 May 2010. RJRT expensed and paid the final judgment in the amount of approximately US$15.2 million on 18 June 2010.

As at 31 December 2010, there have been 10 additional phase three Engle trials naming RJRT as successor to B&W, which proceeded to verdict. Of these ten trials, three resulted in the plaintiffs' verdicts (Douglas, Putney, Grossman). In Douglas, the jury awarded US$5 million in compensatory damages against all defendants on 10

30 Contingent liabilities and financial commitments continued

March 2010, allocating US$250,000 of the award to RJRT. The defendants filed notice of appeal on 28 June 2010. On 29 June 2010, RJRT posted a supersedeas bond in the amount of US$250,000. In Putney, the jury awarded US$15,086,688 in compensatory damages and US$5 million in punitive damages on 26 April 2010, allocating US$4,526,000 in compensatory damages and US$2.5 million in punitive damages to RJRT. The defendants filed a notice of appeal on 30 August 2010, and the plaintiff filed a notice of cross appeal on 31 August 2010. On 20 December 2010, RJRT posted a supersedeas bond in the amount of US$2,372,765. In Grossman, the jury awarded US$1,934,727 in compensatory damages on 29 April 2010, allocating US$483,682 to RJRT. The defendants filed a notice of appeal on 14 July 2010. The plaintiff filed a notice of cross appeal on 19 July 2010. On 19 July 2010, RJRT posted a supersedeas bond in the amount of US$483,682.

In June 2009, the Florida legislature amended its existing bond cap statute by adding a US$200 million bond cap that applies to all phase three Engle cases in the aggregate, and establishes individual bond caps for individual cases in amounts that vary depending on the number of judgments in effect at a given time. In the absence of further legislative action, this bond cap will remain in effect until 31 December 2012.

(c) Individual cases
Approximately 3,161 cases were pending against B&W at 31 December 2010 (2009: 3,191) filed by or on behalf of individuals in which it is contended that diseases or deaths have been caused by cigarette smoking or by exposure to ETS. Of these cases, approximately: (a) 2,590 are ETS cases brought by flight attendants who were members of a class action (Broin) that was settled on terms that allow compensatory but not punitive damages claims by class members; (b) 429 of the individual cases against B&W are cases brought in consolidated proceedings in West Virginia, where the first phase of the trial is scheduled to begin on 17 October 2011; (c) 49 are Engle progeny cases that have been filed directly against B&W, and (d) 93 are cases filed by other individuals (76 of which name B&W and 17 of which name RJRT as successor to B&W). As mentioned above there are a further 6,286 Engle progeny cases which name RJRT as successor to B&W. These cases are subject to the indemnity set out above and are not detailed here.

There were three individual cases that resulted in verdicts against B&W and which remained on appeal during 2010 (not including Lukacs, see above):

In December 2003, a New York jury (Frankson) awarded US$350,000 in compensatory damages against B&W and two industry organisations. In January 2004, the same jury awarded US$20 million in punitive damages. On 22 June 2004, the trial judge granted a new trial unless the parties agreed to an increase in compensatory damages to US$500,000 and a decrease in punitive damages to US$5 million, of which US$4 million would be awarded against B&W. The plaintiff agreed to a decrease in punitive damages, but B&W has not agreed to an increase in compensatory damages. On 25 January 2005, B&W appealed to an intermediate New York State appellate court. Oral argument was heard on 8 May 2006. The appellate court affirmed the judgment on 5 July 2006, except insofar as it dismissed the plaintiff's design defect claims. B&W filed a motion for leave to reargue, or in the alternative, for leave to appeal to the New York Court of Appeals, on 3 August 2006. The intermediate appellate court denied this motion on 5 October 2006. On 8 December 2006, the trial judge granted the plaintiff's application for entry of judgment in the amounts of US$5 million in punitive damages and US$175,000 in compensatory damages. The trial court also granted the plaintiff's motion to vacate that part of the 2004 order granting a new trial unless the parties agreed to an increase in compensatory damages to US$500,000. RJRT posted a bond in the approximate amount of US$8.018 million on 3 July 2007. B&W appealed from final judgment on 3 July 2007 to an intermediate New York State appellate court. Oral argument was heard on 28 January 2009. On 29 September 2009, the appellate court issued a decision modifying the final judgment by deleting the award of punitive damages, and remanding the case to the trial court for a new trial on the issue of punitive damages. On 22 December 2009, the plaintiff requested an extension of time to move for leave to appeal to the New York Court of Appeals, and for leave to reargue the case to the appellate court. On 15 January 2010, the appellate court denied the plaintiff's motion for additional time to seek leave to appeal to the New York Court of Appeals, but granted the plaintiff more time to file a motion for leave to reargue to the appellate court. The plaintiff's motion for leave to reargue was denied by the appellate court on 12 March 2010. As at 31 December 2010, no date has been set for a new trial on the issue of punitive damages.

On 1 February 2005, a Missouri jury (Lincoln Smith) awarded US$500,000 in compensatory damages against B&W and then, on 2 February 2005, awarded US$20 million in punitive damages, also against B&W. On 1 June 2005, B&W filed its notice of appeal. Oral argument was heard on 31 August 2006. On 31 July 2007, an intermediate Missouri appellate court affirmed the compensatory damages award, but it reversed the punitive damages award, reasoning that the plaintiffs failed to produce sufficient evidence to justify the verdict. The majority of the court would have remanded the case for a second trial, limited to punitive damages, but a dissenting judge transferred the case to the Missouri Supreme Court, as permitted by Missouri law. Oral argument was heard by the Missouri Supreme Court on 13 February 2008. On 31 July 2008, the Missouri Supreme Court transferred the case back to the intermediate appellate court for further proceedings. In a decision entered on 16 December 2008, the intermediate appellate court again upheld the award of compensatory damages and reversed the jury's award of US$20 million in punitive damages, sending the case back to the trial court for a new trial on punitive damages. Following a new trial, on 20 August 2009, a Missouri jury returned a verdict awarding US$1.5 million in punitive damages against B&W. On 24 September 2009, B&W filed a motion for a new trial and a motion for judgment notwithstanding the verdict. On the same date, the plaintiffs filed a motion for additur, asking the court to increase the amount of punitive damages from US$1.5 million to US$20 million, and a motion to vacate, modify or set aside judgment, or

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30 Contingent liabilities and financial commitments continued

in the alternative, for a new trial. On 21 December 2009, the court denied the plaintiffs' and B&W's post-trial motions. On 30 December 2009, B&W filed a notice of appeal. On 31 December 2009, the plaintiffs filed a notice of appeal. Both appeals remain pending.

On 18 March 2005, a New York jury (Rose) awarded US$1.7 million in compensatory damages against B&W. On 18 August 2005, B&W filed its notice of appeal. RJRT posted a bond in the approximate amount of US$2.058 million on 7 February 2006. Oral argument on this appeal was heard on 12 December 2006 by an intermediate New York appellate court. On 10 April 2008, the appellate court reversed the judgment in the plaintiff's favour and ordered that the case be dismissed. On 8 May 2008, the plaintiff filed a notice of appeal to New York's Court of Appeals. On 16 December 2008, the New York Court of Appeals affirmed the decision of the appellate court dismissing the plaintiff's complaint. On 14 January 2009, the plaintiff filed a motion seeking leave to reargue the 16 December 2008 decision and order of the New York Court of Appeals, which was denied by an order dated 26 March 2009. The plaintiff filed a petition for a writ of certiorari in the US Supreme Court in June 2009, which was denied on 5 October 2009.

(d) Other claims

The Flintkote Company (Flintkote), a US asbestos production and sales company, was included in the acquisition of Genstar Corporation by Imasco Limited's subsidiary, Imasco Enterprises, Inc., in 1986 and became a Group subsidiary following the restructuring of Imasco Limited (now Imperial Tobacco Canada Limited (Imperial), the Group's operating company in Canada) in 2000. Soon after this acquisition, and as part of the acquisition plan, Genstar Corporation began to sell most of its assets, including the non-asbestos related operations and subsidiaries of Flintkote. The liquidation of Flintkote assets produced cash proceeds and, having obtained advice from the law firm of Sullivan & Cromwell LLP and other advice that sufficient assets would remain to satisfy liabilities, Flintkote authorised the payment of a dividend of US$170.2 million in 1986 and a further dividend of US$355 million in 1987. In 2003, Imperial's subsidiary, Genstar Pacific Corporation, divested Flintkote and then, in 2004, Flintkote filed for bankruptcy in the United States Bankruptcy Court for the District of Delaware. In 2006, Flintkote, representatives of both the present and future asbestos claimants, and individual asbestos claimants were permitted by the bankruptcy court to file a complaint against Imperial and numerous other defendants including Sullivan & Cromwell LLP, for the recovery of the dividends, plus interest, and other compensation under various legal and equitable theories, including seeking a determination that Imperial is Flintkote's 'alter ego' and is responsible for all of Flintkote's asbestos tort liabilities. Sullivan & Cromwell LLP and Imperial have since filed cross complaints against each other. The parties are presently engaged in case management discussions to establish the scope and manner of discovery in this case. Although the Flintkote litigation is at a preliminary stage, the judge has stated an intention to determine several discrete issues for resolution in a series of bifurcated bench trials in an effort to simplify or clarify the determinative issues in the litigation. The first issue is whether Flintkote's claim for malpractice against Sullivan & Cromwell LLP is time barred. On 31 January 2011, the court entered a preliminary ruling stating that the complaint was time barred and that Sullivan & Cromwell LLP is entitled to dismissal. The second issue involves an enquiry into the two dividends and the circumstances surrounding them, including issues involving fraudulent conveyance. Certain legal issues regarding fraudulent conveyance were briefed and, at hearings held on 22 December 2010 and 2 February 2011, the court further refined the list of issues involving fraudulent conveyance. In addition, two other issues have emerged: (1) whether Flintkote or certain asbestos tort claimants are able to pursue 'alter ego' claims against Imperial, and (2) whether Flintkote should be judicially estopped from asserting certain fraudulent conveyance remedies in light of prior inconsistent statements it made during the course of the litigation. While it is expected that bench trials on all of these issues will occur in 2011, it is unclear when the court might rule on the issues.

In Wisconsin, the authorities have identified potentially responsible parties (PRPs) to fund the clean up of river sediments in the lower Fox River, Wisconsin. The pollution was caused by discharges of PCBs from paper mills and other facilities operating close to the river. The cost of the clean up work has been estimated to be in excess of US$900 million. Among the potentially responsible parties are NCR Corporation (NCR) and Appleton Papers Inc. (Appleton) who are liable for the clean up costs in a large portion of the river under the terms of a consent decree. In 1978, Industries purchased what was then NCR's Appleton Papers Division from NCR. In 1978, Industries also incorporated a US entity by the name of BATUS, Inc. (BATUS), which in 1980 became the holding company for all of Industries' US subsidiaries, including Appleton. As the holding company, BATUS obtained insurance policies for itself and its subsidiaries that included coverage for certain environmental liabilities. Industries/BATUS spun off the Appleton business in 1990 to Wiggins Teape Appleton p.l.c. and Wiggins Teape Appleton (Holdings) p.l.c., now known as Arjo Wiggins Appleton Ltd. and Arjo Wiggins US Holdings Ltd. (collectively, the AWA Entities), obtaining full indemnities from AWA Entities for past and future environmental claims. Disputes between NCR, Appleton, the AWA Entities, and Industries as to the indemnities given and received under the purchase agreement in 1978 have been the subject of arbitrations in 1998 and 2006. Under the terms of the arbitration awards, Industries and Appleton/the AWA Entities have an obligation to share the costs of environmental claims with NCR (60:40), but Industries has never been required to pay any sums in this regard because Appleton and the AWA Entities have paid the non NCR (60 per cent) share of the clean up costs to date, and the authorities have not identified Industries or BATUS as PRPs. However, there is a risk for Industries that Appleton and the AWA Entities will exhaust the recoverable insurance policies prior to the completion of the mandated clean up work and that Appleton and the AWA Entities will not have sufficient assets of their own to pay the clean up obligations, leaving Industries with the responsibility to pay the non NCR share of the remaining clean up costs. There is a further risk that the clean up costs for the project will increase beyond current estimates.

30 Contingent liabilities and financial commitments continued

UK-based Group companies

Investments has been served in the following US cases pending at 31 December 2010: a medical reimbursement case, City of St. Louis, and Cleary, a class action (see above under medical reimbursement cases and class actions respectively); the US Department of Justice case (see below); an anti-trust case, Daric Smith (see below); and two individual actions, Eiser and Perry, which are currently dormant. No other UK based Group company has been served in a US product liability case pending as at 31 December 2010.

Conduct-based claims

On 22 September 1999, the US Department of Justice brought an action in the US District Court for the District of Columbia against various industry members, including RJRT, B&W, Industries and Investments. Industries was dismissed for lack of personal jurisdiction on 28 September 2000. The government sought to recover federal funds expended in providing healthcare to smokers who have developed diseases and injuries alleged to be smoking-related, and, in addition, sought, pursuant to RICO, disgorgement of profits the government contends were earned as a consequence of a RICO 'enterprise'. On 28 September 2000, the district court dismissed the portion of the claim which sought recovery of federal funds expended in providing healthcare to smokers who have developed diseases and injuries alleged to be smoking-related. The non-jury trial of the RICO portion of the claim began on 21 September 2004, and ended on 9 June 2005. On 17 November 2004, the US Court of Appeals for the DC Circuit heard an appeal by the defendants against an earlier district court decision that disgorgement of profits is an appropriate remedy for the RICO violations alleged by the government. On 4 February 2005, the DC Circuit allowed the appeal, ruling that the government could not claim disgorgement of profits. On 17 October 2005, the US Supreme Court declined to hear the appeal by the US government in respect of the claim for disgorgement of US$280 billion of past profits from the defendants.

On 17 August 2006, the district court issued its final judgment, consisting of some 1,600 pages of factual findings and legal conclusions. The court found in favour of the government, and against certain defendants, including B&W and Investments. The court also ordered a wide array of injunctive relief, including a ban on the use of 'lights' and other similar descriptors. Compliance with the court-ordered remedies may cost RJRT and Investments millions of dollars, although remedial compliance has been stayed over the last several years pending appellate review. In addition, the government is seeking the recovery of roughly US$1.9 million (plus accruable interest) in litigation costs, with RJRT having already paid approximately US$780,000 in costs on behalf of itself and B&W. Investments filed a praecipe with the district court on 28 September 2010 stating that it is not yet obligated to pay costs inasmuch as there has not been final resolution of all appeals in this matter (including the extraterritorial reach, if any, of the RICO statute based on an intervening change in law).

On 10 August 2007, the defendants filed their initial appellate briefs to the Court of Appeals for the DC Circuit. All defendants filed a joint appellate brief, and Investments also filed its own brief which raised the issue of whether Congress intended for RICO to apply to extraterritorial conduct by a foreign defendant. On 19 November 2007, the government filed its opposition and cross-appeal brief, seeking to reinstate certain remedial relief, including its disgorgement claims. On 22 May 2009, a three-judge appellate panel unanimously affirmed the district court's RICO liability judgment against Investments, Altria, Philip Morris, RJRT and Lorillard, ordered the dismissal of CTR and TI (two defunct US trade associations that were not covered by the district court's injunctive remedies), and remanded for further factual findings and clarification as to whether liability should be imposed against B&W, based on changes in the nature of B&W's business operations. The panel also remanded on four discrete issues relating to the remedies, including for the district court "to reformulate" the injunction on the use of low-tar descriptors "to exempt foreign activities that have no substantial, direct, and foreseeable domestic effects". The government's cross-appeal seeking disgorgement of past profits and the funding of smoking education and cessation programmes was denied. Investments' petition for panel rehearing and rehearing en banc were filed on 31 July 2009 and was denied on 22 September 2009 by the DC Circuit.

On 19 February 2010, the defendants and the government filed certiorari petitions with the US Supreme Court. On 28 June 2010, the US Supreme Court declined to grant certiorari on all petitions. On 23 July 2010, Investments filed a petition for rehearing before the US Supreme Court, on the basis of an intervening decision by the High Court that invalidated the "effects" test the district court and DC Circuit both used in concluding that the RICO statute applied to Investments' foreign conduct. The US Supreme Court denied Investments' rehearing petition on 3 September 2010.

On 7 July 2010, the DC Circuit issued its remand returning the case to the district court for further proceedings. On 22 December 2010, the district court ordered, among other things, that B&W is no longer a defendant and is therefore not subject to the court's injunction. On 28 December 2010, the government filed a motion to compel Investments' compliance with the district court's 17 August 2006 order. Investments' opposition to the government's motion to compel compliance along with Investments' motion for reconsideration of the liability judgment against it on the basis of an intervening change in controlling law was filed on 21 January 2011.

In the Daric Smith case, purchasers of cigarettes in the State of Kansas brought a class action in the Kansas State Court against B&W, Investments and certain other tobacco companies seeking injunctive relief, treble damages, interest and costs. The allegations are that the defendants participated in a conspiracy to fix or maintain the price of cigarettes sold in the US, including the State of Kansas, in violation of the Kansas Restraint of Trade Act. Following a hearing on 8 December 2008 on the plaintiff's motion to compel Investments to produce documents, Investments identified relevant documents for discovery and Judge Smith (now retired) issued an order compelling disclosure of all of Investments' documents without an

Notes on the accounts (continued)

30 Contingent liabilities and financial commitments continued

in camera review. On 15 October 2009, Investments filed a motion for reconsideration of Judge Smith's order. A decision on this is awaited. Following the appointment of a new judge, in October and November 2010, all defendants moved for summary judgment. Those motions have not yet been fully briefed.

Product liability outside the United States

At 31 December 2010, active claims against the Group's companies existed in 22 markets outside the US (2009: 22) but the only markets with more than five claims were Argentina, Brazil, Canada, Chile, Italy, Nigeria, and the Republic of Ireland (2009: five). Medical reimbursement actions are being brought in Canada, Argentina, Brazil, Colombia, Israel, Nigeria, Saudi Arabia and Spain.

(a) Medical reimbursement cases

Brazil

In August 2007, the São Paulo Public Prosecutors office filed a medical reimbursement claim against Souza Cruz. A similar claim was lodged against Philip Morris. Souza Cruz's motion to consolidate the two claims was rejected and instead this case was removed to a different lower court. Souza Cruz filed a motion to reconsider the refusal for consolidation and an interlocutory appeal against assignment to the lower court. At the same time, the Public Prosecutor filed a motion challenging the connection between the two cases, which argument the State Court of Appeals accepted in August 2010 and ordered the two cases to progress independently. Souza Cruz subsequently filed a motion for clarification opposing the ruling, which is now pending review with the reporting justice. The lower court proceedings against Souza Cruz are expected to resume in due course.

Canada

In Canada there are three statutory actions for recovery of healthcare costs arising from the treatment of smoking and health related diseases. These proceedings name various group companies. Legislation enabling provincial governments to recover the healthcare costs has been enacted in British Columbia, New Brunswick, Ontario and Quebec. Actions have begun against various Group companies in British Columbia, New Brunswick and Ontario. In Quebec, the Group companies are challenging the legislation, and Quebec has not filed its own action. Newfoundland is in the process of referring legislation to the Newfoundland Court of Appeals. Similar legislation has also been passed and is also being considered by other Canadian provinces.

The government of British Columbia brought a claim pursuant to the provisions of the Tobacco Damages and Health Care Costs Recovery Act 2000 (the Recovery Act) against domestic and foreign 'manufacturers' seeking to recover the plaintiff's costs of healthcare benefits. Imperial, Investments, Industries and other former Rothmans Group companies are named as defendants. The constitutionality of the Recovery Act was challenged by certain defendants and, on 5 June 2003, the British Columbia Supreme Court found the Recovery Act to be beyond the competence of the British Columbia legislature and, accordingly, dismissed the government's claim. The government appealed the decision to the British Columbia Court of Appeal which, on 20 May 2004, overturned the lower court's decision and declared the Recovery Act to be constitutionally valid. The defendants appealed to the Supreme Court of Canada in June and the court gave its judgment in September 2005 dismissing the appeals and declaring the Act to be constitutionally valid.

The federal government was enjoined by a Third Party Notice, and presented a Motion to Strike the claim out. The hearing took place during the week of 3 March 2008 and the court found in favour of the federal government. The defendants appealed that decision and the hearing was held during the week of 1 June 2009. On 8 December 2009, the British Columbia Court of Appeal handed down its decision in both this case and the Knight class action. This appeal was granted in part. The Court of Appeal held that it was not "plain and obvious" that the federal government did not owe a duty of care to tobacco manufacturers or consumers when it implemented its tobacco control strategy.

On 8 February 2010, the federal government sought leave to appeal this decision to the Supreme Court of Canada. On 10 March, the defendant filed response materials and a cross appeal. The government of British Columbia sought leave to oppose the defendants' cross appeal in part. On 20 May, the Supreme Court of Canada granted leave to appeal both in respect of the federal government's application and the defendants' conditional cross applications. The appeal is scheduled to be heard on 24 February 2011.

The underlying medical reimbursement action remains at a preliminary case management stage. Damages have not yet been quantified by the plaintiff. Given the Supreme Court application, and a number of other factors including delay on the part of the plaintiff in producing his damages modelling materials, the trial date has been postponed.

Non-Canadian defendants challenged the personal jurisdiction of the British Columbia Court and those motions were heard in the Supreme Court of British Columbia. On 23 June 2005, the court dismissed all defendants' motions, finding that there is a "real and substantial connection" between British Columbia and the foreign defendants. Subsequently, the defendants were granted leave to appeal that ruling to the Court of Appeal of British Columbia. The appeal was dismissed on 15 September 2006. The defendants filed leave to appeal to the Supreme Court on 10 November 2006, and that application was denied on 5 April 2007.

The government of New Brunswick has brought a medical reimbursement claim against domestic and foreign tobacco "manufacturers", pursuant to the provisions of the Recovery Act passed in that Province in June 2006. The Company, Investments, Industries, Imperial and Carreras Rothmans Limited (the UK Companies) have all been named as defendants. The government filed a statement of claim on 13 March 2008. The Group defendants were served with the Notice of Action and Statement of Claim on 2 June 2008. A case management conference was held on 8 January 2009 so that other defendants could challenge the use of a contingent fee arrangement (CFA) for the plaintiff's lawyer. This challenge was refused at first instance. Leave to appeal was granted on limited grounds. These grounds, upon which leave was denied, were appealed directly to the Supreme Court of Canada. On 13 May 2010, the New Brunswick Court of Appeal dismissed Imperial's appeal.

30 Contingent liabilities and financial commitments continued

The Supreme Court of Canada subsequently denied leave on all aspects of the CFA challenge, thus ending this preliminary challenge. The appeal was dismissed and an application to appeal to the Supreme Court was denied on 21 October 2010. The UK Companies have challenged the court's jurisdiction and in November 2010 all four challenges were refused. Appeals are ongoing. No damages have yet been quantified by the plaintiff.

The government of the Province of Ontario has also filed a C$50 billion medical reimbursement claim against domestic and foreign tobacco "manufacturers", pursuant to the provisions of the Tobacco Damages and Health Care Costs Recovery Act 2009. The UK Companies have all been named as defendants. Imperial was served on 30 September 2009 and the UK Companies were served on 8 October 2009. A case management judge has been appointed and the jurisdiction motions filed by the UK Companies will be heard first. The hearing is scheduled for April 2011.

Colombia

British American Tobacco (South America) Limited (BAT South America) was served on 18 July 2008 in a public interest action that has a medical reimbursement component. The case was brought by two Colombian citizens alleging that the defendant violated numerous "collective" interests and rights of the Colombian population. In addition to equitable and injunctive relief being sought, the plaintiffs are seeking 25 per cent of smoking-related healthcare costs since the time that British American Tobacco has been operating in Colombia. Thereafter, the plaintiffs also request that the company contribute US$50 million a year to a fund. BAT South America initially filed preliminary objections to the action, with a view to joining the claim with another class action, the Sandra Florez action (which made substantially similar allegations and sought similar relief). However, as the Florez case was decided in BAT South America's favour in September 2009, BAT South America will submit a full defence in due course.

Israel

In Israel, a medical reimbursement claim was brought against Industries, B&W, Investments and B.A.T (U.K. and Export) Limited (BATUKE), amongst others, by Clalit Health Services. The plaintiff claims damages of NIS7.6 billion and seeks injunctive relief. On 29 March 2005, B&W, Investments and BATUKE argued for leave to appeal the denial of their application to dismiss the action on the grounds of remoteness and a decision from the Supreme Court on this issue is still awaited.

Nigeria

Health care recoupment actions have also been brought by five Nigerian states (Lagos, Kano, Gombe, Oyo, Ogun) and by the federal government of Nigeria, each seeking the equivalent of billions of US dollars for costs allegedly incurred by the state and federal governments in treating smoking-related illnesses. British American Tobacco (Nigeria) Limited (BAT Nigeria) has been named as a defendant in each of the cases; the Company and Investments have been named as defendants in six of the cases.

As at 31 December 2010, the actions that had been filed by the Attorneys-General of Ondo State and of Ekiti State were voluntarily discontinued by the plaintiffs without prejudice to re-file on 5 October 2009 and 18 June 2009, respectively. The action filed by the Attorney-General of Akwa Ibom State was struck out without prejudice for lack of prosecution on 19 October 2009.

On 21 February 2008, the Lagos action was voluntarily discontinued by the plaintiffs. On 13 March 2008, the Lagos Attorney General filed a substantially similar action which was marked as 'qualified' under Lagos State's 'Fast-Track' system. The 'Fast-Track' system provides for resolution of the dispute within an eight-month time-period after filing. BAT Nigeria, the Company and Investments have all been served in the new action, and have filed preliminary objections. At a hearing on 16 September 2008, because service was yet to be completed on all defendants, the court directed that the case no longer qualified to be heard on the 'Fast Track'. On 18 September 2009, the court issued a ruling denying the preliminary objections filed by the Company and Investments on the basis that the court was competent to hear the case as it related to those defendants, that the Company and Investments are necessary parties to the action and that the suit therefore was not liable to be struck out as against those defendants. On 2 October 2009, the Company and Investments filed notices of appeal from the entirety of the court's ruling as it related to their respective objections. On 15 October and 19 October 2009, respectively, the Company and Investments filed motions to stay all proceedings pending the resolution of their appeals, which motion was granted by the High Court on 20 September 2010. On 26 November 2010, the Lagos Attorney General filed a motion for leave to appeal the High Court's order granting a stay, which motion remains pending before the Court of Appeal.

On 8 July 2008, the High Court of Gombe State issued a ruling on the preliminary objections filed by the Company, Investments and other defendants in the case, setting aside the service on all defendants and striking out the Gombe suit. In its decision, the court held that the writs served on the defendants were invalid, the plaintiff had failed to pay the requisite filing fees, and that based on these filing defects, the court was not competent to assume jurisdiction. The court also stated, however, that the plaintiff, through its statement of claim and affidavit evidence filed in support of its ex parte motion for leave to serve outside the jurisdiction, had satisfied the requirements for service outside the jurisdiction. Although the plaintiff has not appealed from the court's decision, the plaintiff has filed a renewed action in the High Court of Gombe State. BAT Nigeria, the Company and Investments have filed notices of preliminary objection in the renewed action. On 16 December 2010, the Gombe High Court heard argument on the defendants' service and jurisdictional objections.

In the Oyo State case the British American Tobacco companies filed preliminary objections. These were partially granted on 22 June 2010 and service was set aside. The issuance of the writ was, however, not set aside and the Company and Investments are appealing this decision based on their jurisdictional objections. As at 31 December 2010, the appeals remain pending, and the plaintiff has not re-served the writ on the British American Tobacco defendants.

Notes on the accounts (continued)

30 Contingent liabilities and financial commitments continued

In Kano, the preliminary objections filed by the Company and Investments were dismissed on 16 April 2010. The Company and Investments have appealed the decision and sought a stay of proceedings. On 13 May 2010, the plaintiff filed a motion for preliminary injunction which seeks inter alia to prevent the defendants from marketing tobacco products or causing them to be sold to underage purchasers or near any primary or secondary school in Kano State. At a hearing on 8 December 2010 the court heard argument concerning the order in which the stay application, injunction motion, and other pending matters will be heard, and adjourned to 20 January 2011 for ruling. On 20 January 2011, the court ruled that it would first hear Nigeria's preliminary objections to the court's jurisdiction, and subsequently would hear the defendants' stay applications together with the plaintiff's injunction motion, and adjourned to 22 February 2011 for a hearing on BAT Nigeria's objections.

In Ogun, preliminary objections were filed by BAT Nigeria, the Company and Investments, but were rejected by the court on 20 May 2010. All three British American Tobacco defendants have filed appeals. On 24 May 2010, the plaintiff filed a motion for preliminary injunction which seeks inter alia to prevent the defendants from marketing tobacco products or causing them to be sold to underage purchasers or near any primary or secondary school in Ogun State. On 15 and 19 October 2010, the Company and Investments, respectively, filed motions in the Court of Appeal for a stay of proceedings pending their appeals. On 21 October 2010, the High Court adjourned proceedings without date pending resolution of the stay motions. As at 31 December 2010, the stay motions remain pending before the Court of Appeal and a hearing is scheduled for 31 March 2011.

Saudi Arabia

In Saudi Arabia, in 2007, there were reports that the Ministry of Health was pursuing a healthcare recoupment action in the Riyadh General Court against a number of distributors and agents. As at 31 December 2010, no Group company has been served with process. The Ministry of Health is reportedly seeking damages of at least 127 billion Saudi riyals. Hearings take place on average every six months.

In addition, a separate medical reimbursement action has reportedly been filed by the King Faisal Specialist Hospital in the Riyadh General Court, naming 'BAT Company Limited' as a defendant. As at 31 December 2010, no Group company had been served with process in the action.

Spain

In early 2006, the Junta de Andalucia, in Spain, filed a medical reimbursement action against the State and tobacco companies (including BAT España S.A.) before the contentious-administrative courts. The State filed preliminary objections to the Junta's claim, with tobacco companies filing supporting briefs. The court upheld these preliminary objections and dismissed the claim in November 2007. The Junta's appeal of this ruling to the Supreme Court was dismissed in September 2009. However, in May 2009, the Junta also filed a new contentious-administrative claim following inactivity on their previous claim, which proceedings are still progressing.

Preliminary objections were made in May 2010 and the parties are awaiting the court's ruling.

(b) Class actions

Brazil

There are five class actions being brought in Brazil. One is also a medical reimbursement, and is therefore discussed above.

In 1995, the Associação de Defesa da Saúde do Fumante (ADESF) class action was filed against Souza Cruz S.A. (Souza Cruz) and Philip Morris in the São Paulo Lower Civil Court alleging that the defendants are liable to a class of smokers and former smokers for failing to warn of cigarette addiction. The case was stayed in 2004 pending the defendants' appeal from a decision issued by the lower civil court on 7 April 2004. That lower court decision held that the defendants had not met their burden of proving that cigarette smoking was not addictive or harmful to health, notwithstanding an earlier interlocutory order that the São Paulo Court of Appeals had issued, which directed the trial court to allow more evidence to be taken before rendering its decision. On 12 November 2008, the São Paulo Court of Appeals overturned the lower court's unfavourable decision of 2004, finding that the lower court had failed to provide the defendants with an opportunity to produce evidence. The case now returns to the lower court for production of evidence and a new judgment. On 19 March 2009, the Lower Civil Court ordered the previous court-appointed medical expert to be replaced and a new advertising expert appointed. The parties have submitted questions to these court-appointed experts who have both delivered their reports. The plaintiff has provided comments on both expert reports. Souza Cruz responded with its comments and submissions from its own experts on 26 November 2010.

The Brazilian Association for the Defense of Consumers' Health (Saudecon) filed a class action against Souza Cruz in the City of Porto Alegre, Brazil on 3 November 2008. The plaintiff purports to represent all Brazilian smokers whom, it alleges, are unable to quit smoking and lack access to cessation treatments. The plaintiff is seeking an order requiring the named defendants to fund, according to their market share, the purchase of cessation treatments for these smokers over a minimum period of two years. Souza Cruz was served with this complaint on 19 November 2008. On 18 May 2009, the case was dismissed with judgment on the merits. The plaintiffs appealed in August 2009 and Souza Cruz and Philip Morris both responded. The parties are now awaiting judgment from the State Court of Appeal's 10th Civil Chamber.

A class action was filed against Souza Cruz by the Association of Exploited Consumers of the federal District, requesting a court order to prevent Souza Cruz selling cigarettes in Brazil. In December 2006, the federal District Court of Appeals confirmed a favourable lower court decision which had found the claim groundless and unlawful. The plaintiff appealed that ruling, but on 12 March 2009 the Superior Court affirmed the ruling and rejected the plaintiff's appeal. The plaintiff appealed again, but on 23 March 2009, in a unanimous decision, the Superior Court rejected the plaintiff's appeal. An appeal is now pending before the federal Supreme Court.

30 Contingent liabilities and financial commitments continued

In 2004, the State of Sergipe instigated a class action seeking compensation for smokers in Sergipe State who purportedly sought to quit smoking. The lower court denied the plaintiffs' request for early relief and determined ANVISA (a federal government health agency) be ordered to join the case as co-defendants. As ANVISA is a federal agency, the case was removed to the federal court where ANVISA successfully argued that it lacked standing to be sued. The claim against ANVISA was dismissed and the federal court sent the case back to the lower state court for proceedings to continue, however, the action was stayed on 18 December 2009 pending a decision by the Superior Court on which court has jurisdiction. On 26 March 2010 the Superior Court determined that it has jurisdiction of the matter and a decision from the court is now pending.

Bulgaria

In March 2008, a smoking-related consumer fraud class action was filed in the Sofia City Court of Bulgaria against 21 defendants, including the following British American Tobacco-affiliated companies: British-American Tobacco Polska S.A., British-American Tobacco (Romania) Investments SRL, House of Prince A/S, and Scandinavian Tobacco S.A. On 24 September 2008, the claim was dismissed on procedural grounds, and the plaintiff appealed this ruling. On 11 November 2008, the Court of Appeal granted the plaintiff's appeal and on 2 December 2008, the Sofia City Court ordered the plaintiff to meet various evidentiary and procedural conditions before proceeding further with this claim. An ex parte hearing took place on 18 November 2010 to allow the plaintiff to present evidence on his ability to bring the claim and on the viability of the claim itself. On 24 November 2010, the Sofia City Court issued an order denying plaintiff the right to proceed with the claim on the grounds that the class members could not be accurately identified and because plaintiff lacked adequate funding to pursue the litigation on behalf of the proposed class. The plaintiff appealed that ruling and on 20 January 2011, the Court of Appeal affirmed the dismissal of the case.

Canada

There are 10 class actions being brought in Canada against Group companies.

In the Knight class action, a claim has been brought against Imperial under the Trade Practices Act and the Business Practices and Consumer Protection Act. The claim includes alleged deceptive practices in relation to the use of 'light' and 'mild' descriptors. The Supreme Court of British Columbia certified a class of all consumers of cigarettes bearing 'light' or 'mild' descriptors since 1974 manufactured in British Columbia by Imperial. Imperial filed an appeal against the certification which was heard in February 2006. The Appeal Court confirmed the certification of the class but has limited any financial liability, if proved, to the period from 1997. This is a 'lights' class action in which the plaintiff alleges that the marketing of light and mild cigarettes is deceptive because it conveys a false and misleading message that those cigarettes are less harmful than regular cigarettes. Although the claim arises from health concerns, it does not seek compensation for personal injury. Instead it seeks compensation for amounts spent on 'light and mild' products and a disgorgement of profits from Imperial. The motion of the federal government to strike out the third party notice issued against them by Imperial was heard in February 2006 and was granted but was appealed by Imperial and the appeal was heard in June 2009 in conjunction with the British Columbia medical reimbursement. The Court of Appeal went so far as to say that it was not "plain and obvious" that the federal government did not owe a duty of care to manufacturers or indeed to the class itself. Therefore, the government of Canada faces potential liability to claims of product liability or misrepresentation. The government has appealed this decision and the appeal will be heard on 24 February 2011.

On 9 December 2009, Imperial was served with a class action filed by Ontario tobacco farmers and the Provincial Marketing Board. The plaintiffs allege that, during the timeframe, the companies improperly paid lower prices for tobacco leaf destined for duty-free products, as opposed to the higher domestic leaf price. Imperial deposited the amount owing to the government of Ontario pursuant to the Comprehensive Agreement into an escrow account, as Imperial believes that the Growers' claim could fall within the definition of a released claim according to the Comprehensive Agreement. In response, the Ontario government filed an action against Imperial, seeking a declaration to the effect that the Growers' action is valid in its own right, and that it is not a Released Claim. No monetary damages are being claimed against Imperial by the government of Ontario.

On 26 July 2010, Imperial argued its preliminary motion in the Ontario claim. Imperial was successful in its application and the court ordered that the Ontario claim be stayed in favour of the arbitration provisions stipulated in the Comprehensive Agreement and raised by Imperial in its Notice of Arbitration. The Province of Ontario has appealed this decision but no hearing date has been set.

There are currently two class actions in Quebec. On 21 February 2005, the Quebec Superior Court granted certification in two class actions against Imperial and two domestic manufacturers, which have a combined value of C$22 billion plus interest and costs. The court certified two classes, which include residents of Quebec who suffered from lung, throat and laryngeal cancer or emphysema, and residents who were addicted to nicotine at the time the proceedings were filed and who have since remained addicted. In Quebec, there is no right of appeal for a defendant upon certification. The plaintiffs have served a Statement of Claim. Trial in this matter has been set for 17 October 2011 and discovery is currently under way.

In June 2009, four new smoking and health class actions were filed in Nova Scotia, Manitoba, Saskatchewan and Alberta, against Canadian manufacturers and foreign companies, including the UK Companies and Imperial. In June 2010, two further suits were filed in British Columbia. Proceedings in these smoking and health class actions have also been served on Imperial. A jurisdiction motion has been filed in British Columbia. In Saskatchewan, a number of UK companies have been released from the action. In Nova Scotia the proceedings have not progressed. There are service issues in relation to the UK Companies for Alberta and Manitoba.

Notes on the accounts (continued)

30 Contingent liabilities and financial commitments continued

Israel

In May 2008, a 'lights' class action was brought in Israel against a number of parties including British American Tobacco's distributor, which was dismissed on 16 May 2010. The plaintiff's time to appeal that order has expired.

Venezuela

The Venezuelan Federation of Associations of Users and Consumers filed a class action against the Venezuelan government seeking regulatory controls on tobacco and recovery of medical expenses for future expenses of treating smoking-related illnesses in Venezuela. On 19 January 2009, C.A Cigarrera Bigott Sucs. (Cigarrera Bigott) notified the court of its intention to appear as a third party. The court adjourned a public hearing, initially scheduled for 28 July 2009, where Cigarrera Bigott's status as a third party would be determined and parties would present evidence and make arguments. On 16 September 2009, the Venezuelan Republic ordered the court to continue the judicial process. A new date has yet to be scheduled by the court.

(c) Individual personal injury claims

Aside from the US there are approximately 353 individual smoking cases pending world-wide as at 31 December 2010 against Group companies that are not detailed here. Over three-quarters of these cases are in Brazil.

At 31 December 2010, there were only five (2009: approximately 634) individual 'lights' cases in Italy pending against British American Tobacco Italia S.p.A. before the justice of the peace courts. As at 31 October 2010, approximately 4,390 cases had been withdrawn, suspended or resulted in decisions given in favour of British American Tobacco Italia S.p.A. There are 34 smoking and health cases pending before Italian civil courts, filed by or on behalf of individuals in which it is contended that diseases or deaths have been caused by cigarette smoking. There are two labour cases for alleged occupational exposure pending in Italy. There are also seven smoking and health cases and two labour cases on appeal related to the same decision but based on different grounds (Serafini case).

In 2008, three individual smoking and health actions were brought against British American Tobacco Finland Oy, collectively seeking a total of approximately €349,329 plus interest in damages for smoking related diseases. On 10 October 2008, the Helsinki District Court dismissed the plaintiffs' claims in their entirety. Two of the original plaintiffs have appealed the respective judgments of the District Court. A joint de novo trial of the appeals was heard on 31 August 2009 before the Helsinki Court of Appeal. These appeals were dismissed. A further appeal to the Supreme Court was withdrawn on 9 November 2010. The parties agreed to bear their own costs.

Conclusion

While it is impossible to be certain of the outcome of any particular case or of the amount of any possible adverse verdict, the Group believes that the defences of the Group's companies to all these various claims are meritorious on both the law and the facts, and a vigorous defence is being made everywhere. If an adverse judgment is entered against any of the Group's companies in any case, an appeal will be made. Such appeals could require the appellants to post appeal bonds or substitute security in amounts which could in some cases equal or exceed the amount of the judgment. In any event, with regard to US litigation, the Group has the benefit of the RJRT Indemnification. At least in the aggregate, and despite the quality of defences available to the Group, it is not impossible that the Group's results of operations or cash flows in particular quarterly or annual periods could be materially affected by this and by the final outcome of any particular litigation.

Having regard to all these matters, the Group (i) does not consider it appropriate to make any provision in respect of any pending litigation and (ii) does not believe that the ultimate outcome of this litigation will significantly impair the Group's financial condition.

30 Contingent liabilities and financial commitments continued

Operating leases

Total future minimum lease payments under non-cancellable operating leases comprise leases where payments fall due:

	2010 £m	2009 £m
Property		
Within one year	59	71
Between one and five years	149	168
Beyond five years	122	139
	330	378
Plant and equipment		
Within one year	26	29
Between one and five years	25	33
	51	62

31 Post balance sheet events

On 14 January 2011, Reynolds American Inc. (RAI), announced that it had reached an agreement to sell Lane Limited to Scandinavian Tobacco Group A/S (STG). Under the terms of the transaction, STG has agreed to pay US$205 million in cash for Lane. Lane manufactures other tobacco products and contributes approximately US$0.04 per share to RAI's annual earnings which equates to earnings of US$10 million (£6 million) for the Group. The Group disposed of Lane Limited to RAI in 2004. The transaction is expected to close in the first half of 2011, pending anti-trust review and approval.

Five year summary

For the years ended 31 December	2010 £m	2009 £m	2008 £m	2007 £m	2006 £m
Income statement					
Gross turnover (including duty, excise and other taxes)	**43,855**	40,713	33,921	27,104	25,503
Revenue (after deducting duty, excise and other taxes)	**14,883**	14,208	12,122	10,018	9,762
Profit from operations	**4,318**	4,101	3,572	2,904	2,632
Adjusted profit from operations	**4,984**	4,461	3,717	3,002	2,807
Profit before taxation	**4,388**	4,080	3,684	3,077	2,774
Profit for the year	**3,140**	2,956	2,659	2,287	2,057

	2010 pence	2009 pence	2008 pence	2007 pence	2006 pence
Earnings per share					
– basic unadjusted	**145.2**	137.0	123.3	105.2	92.6
– diluted unadjusted	**144.4**	136.3	122.5	104.5	91.8
– diluted adjusted	**175.7**	153.0	128.8	108.5	98.6
Dividends declared per share	**114.2**	99.5	83.7	66.2	55.9

At 31 December	2010 £m	2009 £m	2008 £m	2007 £m	2006 £m
Balance sheet					
Non-current assets	**19,203**	18,508	18,812	13,399	12,401
Current assets	**8,657**	8,106	8,739	5,365	5,391
Total assets	**27,860**	26,614	27,551	18,764	17,792
Owners of the parent	**9,206**	7,613	6,944	6,871	6,357
Non-controlling interests	**342**	299	271	218	227
Total equity	**9,548**	7,912	7,215	7,089	6,584
Non-current liabilities	**10,667**	11,786	11,458	7,131	6,792
Current liabilities	**7,645**	6,916	8,878	4,544	4,416
Total liabilities	**18,312**	18,702	20,336	11,675	11,208
Total equity and liabilities	**27,860**	26,614	27,551	18,764	17,792

Half-yearly analyses of profit

The figures shown below have been produced using average rates of exchange on a half-yearly basis since the beginning of the year. Thus the discrete half year to 30 June has not been restated for subsequent movements in foreign exchange rates during the year, which are reflected in the results for the subsequent half year to 31 December.

	6 months to		Year to
	30 Jun 2010 £m	31 Dec 2010 £m	31 Dec 2010 £m
Profit from operations	2,271	2,047	4,318
Analysed as:			
– adjusted profit from operations	2,460	2,524	4,984
– restructuring and integration costs	(158)	(153)	(311)
– amortisation of trademarks	(31)	(31)	(62)
– impairment of trademarks		(44)	(44)
– goodwill impairment		(249)	(249)
	2,271	2,047	4,318
Net finance costs	(231)	(249)	(480)
Share of post-tax results of associates and joint ventures	239	311	550
Analysed as:			
– adjusted share of post-tax results of associates and joint ventures	306	316	622
– trademark amortisation and impairments		(1)	(1)
– Canadian settlements	(60)	1	(59)
– dilution in shareholding		(9)	(9)
– restructuring costs	(7)	4	(3)
	239	311	550
Profit before taxation	2,279	2,109	4,388
Earnings per share			
Basic	76.9p	68.3p	145.2p
Adjusted diluted	87.1p	88.6p	175.7p

	6 months to		Year to
	30 Jun 2009 £m	31 Dec 2009 £m	31 Dec 2009 £m
Profit from operations	2,111	1,990	4,101
Analysed as:			
– adjusted profit from operations	2,164	2,297	4,461
– restructuring and integration costs	(29)	(275)	(304)
– amortisation of trademarks	(26)	(32)	(58)
– gains on disposal of businesses and trademarks	2		2
	2,111	1,990	4,101
Net finance costs	(219)	(285)	(504)
Share of post-tax results of associates and joint ventures	231	252	483
Analysed as:			
– adjusted share of post-tax results of associates and joint ventures	279	262	541
– trademark impairments	(48)	(17)	(65)
– health plan credit		16	16
– restructuring costs		(9)	(9)
	231	252	483
Profit before taxation	2,123	1,957	4,080
Earnings per share			
Basic	73.2p	63.8p	137.0p
Adjusted diluted	77.3p	75.7p	153.0p

Principal subsidiary and associate undertakings

Principal subsidiary undertakings

	% equity shares held
Centre Corporate Companies	
B.A.T (U.K. and Export) Ltd.	100
B.A.T Capital Corporation (incorporated in the United States of America)	100*
B.A.T. International Finance p.l.c.	100*
BATMark Ltd.	100*
British-American Tobacco (Holdings) Ltd.	100
British American Tobacco Holdings (The Netherlands) B.V. (incorporated in The Netherlands)	100
British American Tobacco International Ltd. (incorporated in Switzerland)	100
British American Tobacco (Brands) Inc. (incorporated in the United States of America)	100
British American Tobacco (Brands) Ltd.	100
British American Tobacco (GLP) Ltd.	100
British American Tobacco (Investments) Ltd.	100
Tobacco Insurance Company Ltd.	100
Asia-Pacific	
Australia	
British American Tobacco Australia Ltd.	100
Bangladesh	
British American Tobacco Bangladesh Company Ltd.	65
Indonesia	
PT Bentoel Internasional Investama Tbk	99
Japan	
British American Tobacco Japan, Ltd.	100
Malaysia	
British American Tobacco (Malaysia) Berhad	50
New Zealand	
British American Tobacco (New Zealand) Ltd.	100
Pakistan	
Pakistan Tobacco Co. Ltd.	94
South Korea	
British American Tobacco Korea Ltd.	100
British American Tobacco Korea Manufacturing Ltd.	100
Taiwan	
B.A.T Services Ltd. (incorporated in the United Kingdom)	100
Vietnam	
British American Tobacco – Vinataba (JV) Ltd.	70
Americas	
Argentina	
Nobleza-Piccardo S.A.I.C.y F.	98
Brazil	
Souza Cruz S.A.	75
Canada	
Imperial Tobacco Canada Ltd.	100
Chile	
British American Tobacco Chile Operaciones S.A.	96
Colombia	
British American Tobacco (South America) Ltd. (incorporated in the United Kingdom)	100
Mexico	
British American Tobacco Mexico, S.A. de C.V.	100
Venezuela	
C.A. Cigarrera Bigott Sucs.	100

	% equity shares held
Western Europe	
Belgium	
British American Tobacco Belgium S.A.	100
Denmark	
British American Tobacco Denmark A/S (House of Prince A/S)	100
France	
British American Tobacco France SAS	100
Germany	
British-American Tobacco (Germany) GmbH	100
British American Tobacco (Industrie) GmbH	100
Greece	
British American Tobacco Hellas S.A.	100
Italy	
British American Tobacco Italia S.p.A.	100
Netherlands	
British American Tobacco Nederland B.V.	100
Poland	
British American Tobacco Polska S.A.	100
British American Tobacco Polska Trading Sp. z.o.o.	100
Spain	
British American Tobacco España, S.A.	100
Sweden	
British American Tobacco Sweden AB	100
Fiedler & Lundgren AB	100
Switzerland	
British American Tobacco Switzerland S.A.	100
United Kingdom	
British American Tobacco UK Ltd.	100
Eastern Europe#	
Kazakhstan	
British American Tobacco Kazakhstan Trading Ltd.	100
Romania	
British-American Tobacco (Romania) Trading SRL	100
Russia	
OJSC British American Tobacco – STF	99
OJSC British American Tobacco – Yava	99†
CJSC British American Tobacco – SPb	100†
CJSC “International Tobacco Marketing Services”	100
Ukraine	
A/T B.A.T. – Prilucky Tobacco Co.	99
Uzbekistan	
UZBAT A.O.	97
Africa and Middle East#	
Egypt	
British American Tobacco Egypt LLC	100
Iran	
B.A.T. Pars Company (Private Joint Stock)	100
Nigeria	
British American Tobacco (Nigeria) Ltd.	100
South Africa	
British American Tobacco Holdings South Africa (Pty) Ltd.	100
Turkey	
British American Tobacco Tütün Mamulleri Sanayi ve Ticaret A.S.	100

The Company has taken advantage of the exemption under Section 410 (2) of the Companies Act 2006 by providing information only in relation to subsidiary undertakings whose results or financial position, in the opinion of the Directors, principally affected the financial statements. The listed subsidiary undertakings are therefore the main corporate entities in those countries which represent the Group's Top 40 markets.

A complete list of subsidiary and associate undertakings will be attached to the next British American Tobacco p.l.c. annual return to the Registrar of Companies.

Subsidiary undertakings held directly by British American Tobacco p.l.c. are indicated thus *; all others are held by sub-holding companies. Unless otherwise stated, Centre Corporate Companies are subsidiary undertakings incorporated in the United Kingdom and the country of incorporation and operation of regional subsidiary undertakings is that under which the company is listed. All subsidiary undertakings are involved in activities related to the manufacture, distribution or sale of tobacco products.

All companies' shares are ordinary shares or common stock except for those indicated thus †, which include preference shares.

The countries and subsidiary undertakings set out above under each of the Eastern Europe and Africa and Middle East regional headings were merged into the enlarged Eastern Europe, Middle East and Africa Region with effect from 1 January 2011.

Principal associate undertakings

		Latest published information (period ended)	Total issued capital £m	% shares held
Americas				
United States of America				
Reynolds American Inc.	▼ Common Stock	31.12.10	*	42
tobacco	▼ Preferred Stock		**	
Asia-Pacific				
India				
ITC Ltd.	▼ Ordinary	31.12.10	110	31
FMCG including tobacco				
agri-business				
paperboard, paper and packaging				
hotels				

▼ Listed overseas.
* As at 31 December 2010, Reynolds American Inc. had issued 583,043,872 shares (US$0.0001 Common Stock), of which the Group held 245,036,858.
** As at 31 December 2010, Reynolds American Inc. had issued 1,000,000 shares (US$0.01 Preferred Stock), in which the Group held no interest.

Independent auditors' report

To the members of British American Tobacco p.l.c.

We have audited the Parent Company financial statements of British American Tobacco p.l.c. for the year ended 31 December 2010 which comprise the Balance sheet and the notes on the accounts. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

Respective responsibilities of Directors and auditors

As explained more fully in the Responsibility of Directors statement set out on page 105, the Directors are responsible for the preparation of the Parent Company financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the Parent Company financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the Company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Parent Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the financial statements.

Opinion on financial statements

In our opinion the Parent Company financial statements:

- give a true and fair view of the state of the Company's affairs as at 31 December 2010;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matters prescribed by the Companies Act 2006

In our opinion:

- the part of the Remuneration report to be audited has been properly prepared in accordance with the Companies Act 2006; and
- the information given in the Directors' report for the financial year for which the Parent Company financial statements are prepared is consistent with the Parent Company financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the Parent Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the Parent Company financial statements and the part of the Remuneration report to be audited are not in agreement with the accounting records and returns; or
- certain disclosures of Directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Other matter

We have reported separately on the Group financial statements of British American Tobacco p.l.c. for the year ended 31 December 2010.

Paul Cragg (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London, United Kingdom

23 February 2011

Balance sheet – British American Tobacco p.l.c.

at 31 December

	Notes	2010 £m	2009 £m
Assets			
Fixed assets			
Investments in Group companies	2	**4,302**	4,295
		4,302	4,295
Current assets			
Debtors	3	**4,693**	4,166
		4,693	4,166
Total assets		**8,995**	8,461
Equity			
Capital and reserves			
Called up share capital		**506**	506
Share premium account		**61**	58
Capital redemption reserves		**101**	101
Other reserves		**90**	90
Profit and loss account		**3,647**	3,173
after deducting – cost of treasury shares		**(740)**	(764)
Shareholders' funds	4	**4,405**	3,928
Liabilities			
Creditors	5	**4,590**	4,533
Total equity and liabilities		**8,995**	8,461

The accompanying notes are an integral part of the Parent Company financial statements.

On behalf of the Board

Richard Burrows
Chairman

23 February 2011

Notes on the accounts

1 Accounting policies

Basis of accounting
The Parent Company financial statements have been prepared on the going concern basis, under the historical cost convention except as described in the accounting policy below on financial instruments and in accordance with the Companies Act 2006 and UK Generally Accepted Accounting Practice.

The Company is a public limited company which is listed on the London Stock Exchange and the Johannesburg Stock Exchange and is incorporated and domiciled in the UK.

Cash flow statement
The cash flows of the Company are included in the consolidated cash flow statement of British American Tobacco p.l.c. which is included in this Annual Report. Consequently the Company is exempt under the terms of FRS 1 (Revised) from publishing a cash flow statement.

Foreign currencies
Transactions arising in currencies other than sterling are translated at the rate of exchange ruling on the date of the transaction. Assets and liabilities expressed in currencies other than sterling are translated at rates of exchange ruling at the end of the financial year. All exchange differences are taken to the profit and loss account in the year.

Accounting for income
Income is included in the profit and loss account when all contractual or other applicable conditions for recognition have been met. Provisions are made for bad and doubtful debts, as appropriate.

Taxation
Taxation provided is that chargeable on the profits of the year, together with deferred taxation. Deferred taxation is provided in full on timing differences between the recognition of gains and losses in the financial statements and their recognition in tax computations. However, the Company does not discount deferred tax assets and liabilities.

Fixed asset investments
Fixed asset investments are stated at cost, together with subsequent capital contributions, less provisions for any impairment in value.

Dividends
Final dividend distributions to the Company's shareholders are recognised as a liability in the financial statements in the period in which the dividends are approved by the Company's shareholders while the interim dividend distributions are recognised in the period in which the dividends are declared and paid.

Repurchase of share capital
When share capital is repurchased, the amount of consideration paid, including directly attributable costs, is recognised as a deduction from equity. Repurchased shares which are not cancelled, or shares purchased for the employee share ownership trusts, are classified as treasury shares and presented as a deduction from total equity.

Related parties
The Company has taken advantage of the exemption under paragraph 3(c) of FRS 8 from disclosing transactions with related parties that are wholly owned subsidiaries of British American Tobacco p.l.c. Group.

Financial instruments
The financial instrument disclosures of the Company are included in the Group financial statements which are included in this Annual Report. Consequently, the Company is exempt under paragraph 2D (b) of FRS 29 from publishing these financial instruments disclosures.

Financial guarantees are recorded at fair value less accumulated amortisation.

2 Investments in Group companies

The Company's directly owned subsidiaries are British American Tobacco (1998) Limited, B.A.T. International Finance p.l.c., B.A.T Capital Corporation and BATMark Limited. During 2009, the Company disposed of British American Ventures Limited for a consideration of £2 to another Group company. British American Tobacco QUEST Limited was a directly owned subsidiary of the Company until it was struck off the Register of Companies in February 2010.

The Directors are of the opinion that the individual investments in the subsidiary undertakings have a value not less than the amount at which they are shown in the Balance Sheet.

	2010 £m	2009 £m
1 January	**4,295**	4,063
Additions	**7**	232
31 December	**4,302**	4,295

On 10 February 2009, the Company subscribed for 230,000,000 £1 shares in B.A.T. International Finance p.l.c. for a consideration of £230 million.

3 Debtors

	2010 £m	2009 £m
Amounts due from Group undertakings	4,693	4,166

Included in debtors are amounts of £53 million (2009: £68 million) falling due after one year.

4 Shareholders' funds

	Share capital £m	Share premium account £m	Capital redemption reserves £m	Other reserves £m	Profit and loss account £m	Total £m
1 January 2010	506	58	101	90	3,173	3,928
Increase in share capital – share options		3				3
Profit for the year					2,541	2,541
Dividends and other appropriations ordinary shares (note 8)					(2,093)	(2,093)
Consideration paid for purchase of own shares held in employee share ownership trusts					(62)	(62)
Consideration received on the exercise of options over own shares held in employee share ownership trusts					4	4
Other movements					84	84
31 December 2010	506	61	101	90	3,647	4,405

Dividends paid are recognised in the year in which they are approved by shareholders, and dividends received are recognised in the year in which they are received. The final dividend which has been declared for the year ended 31 December 2010 is shown in note 8 to the Group financial statements and will be recognised in the financial statements for the year ended 31 December 2011.

As permitted by Section 408 of the Companies Act 2006, the profit and loss of the Company has not been presented in these financial statements. The profit for the year ended 31 December 2010 was £2,541 million (2009: £1,851 million).

Details of Directors' remuneration, share options and retirement benefits are given in the Remuneration Report. Details of key management compensation are included in note 29 of the Group financial statements. The Company had four employees at 31 December 2010 (2009: three). The cost of these employees are borne by another Group company.

Shareholders' funds are stated after deducting the cost of treasury shares which include £523 million (2009: £523 million) for shares repurchased and not cancelled and £217 million (2009: £241 million) in respect of the cost of own shares held in employee share ownership trusts.

Share capital	Ordinary shares of 25p each Number of shares	£m
Allotted, called up and fully paid		
1 January 2010	2,025,364,622	506.34
Changes during the year		
– share option schemes	391,736	0.10
31 December 2010	2,025,756,358	506.44

Notes on the accounts (continued)

4 Shareholders' funds continued

Share capital	Ordinary shares of 25p each Number of shares	£m
Allotted, called up and fully paid		
1 January 2009	2,025,031,151	506.26
Changes during the year		
– share option schemes	333,471	0.08
31 December 2009	2,025,364,622	506.34

Share premium

The increase of £3 million in 2010 relates solely to ordinary shares issued under the Company's share option schemes. These schemes are described in the Remuneration Report.

5 Creditors

	2010 £m	2009 £m
Amounts due to Group undertakings	**823**	741
Loans due to Group undertakings	**3,617**	3,617
Sundry creditors	**150**	175
	4,590	4,533

Included in creditors are amounts of £103 million (2009: £112 million) falling due after more than one year.

Loans due to Group undertakings are unsecured and bear interest at rates between 1.34 per cent and 1.93 per cent (2009: 1.34 per cent and 6.32 per cent).

6 Audit fees

	2010	2009
Fees payable to PricewaterhouseCoopers LLP		
– Audit fees	**£30,000**	£30,000
– Fees paid for other services	**£nil**	£nil

7 Contingent liabilities and financial commitments

British American Tobacco p.l.c. has guaranteed borrowings by subsidiary undertakings of £9.3 billion (2009: £10.1 billion) and total borrowing facilities of £16.3 billion (2009: £17.1 billion).

There are contingent liabilities in respect of litigation in various countries (note 30 to the Group financial statements). In addition, the Company has cross-guaranteed the liabilities of the British American Tobacco UK Pension Fund which had a deficit according to the last formal tri-annual actuarial valuation in March 2008 of £537 million and which had a deficit on a FRS17 basis at 31 December 2010 of £221 million (2009: £604 million).

Shareholder and contact information

Listings and shareholder services

Premium listing

London Stock Exchange (Share Code: BATS; ISIN: GB0002875804)

United Kingdom Registrar
Computershare Investor Services PLC
The Pavilions, Bridgwater Road, Bristol BS99 6ZZ
tel: 0800 408 0094; +44 870 889 3159
web-based enquiries: www.investorcentre.co.uk/contactus

www.computershare.com/uk/investor/bri
Access the web-based enquiry service for shareholders operated by Computershare Investor Services in the UK; view details of your British American Tobacco shareholding and recent dividend payments and register for shareholder electronic communications to receive notification of British American Tobacco shareholder mailings by email.

www.computershare.com/dealing/uk
Go online or telephone 0870 703 0084 (UK) to buy or sell British American Tobacco shares traded on the London Stock Exchange. This service is only available to shareholders in countries where settlement can be made in sterling or euros.

Secondary listing

JSE (Share Code: BTI)

Shares are traded in electronic form only and transactions settled electronically through Strate.

South Africa Registrar
Computershare Investor Services (Pty) Ltd
PO Box 61051, Marshalltown 2107, South Africa
tel: 0861 100 925; +27 11 870 8222
email enquiries: web.queries@computershare.co.za

American Depositary Receipts

NYSE Amex Equities (Symbol: BTI; CUSIP No. 110448107)

British American Tobacco sponsors an American Depositary Receipt (ADR) programme in the United States. Each ADR represents two of the Company's ordinary shares.

Enquiries regarding ADR holder accounts and payment of dividends should be directed to:
Citibank Shareholder Services
P.O. Box 43077, Providence, Rhode Island 02940-3077, USA
tel: 1-888 985-2055 (toll-free) or +1 781 575 4555
email enquiries: citibank@shareholders-online.com
website: www.citi.com/dr

Publications

Copies of current and past Annual Reports are available on request. Copies of the Group corporate descriptive booklet About us are also available. Highlights from these publications can be produced in alternative formats such as Braille, audio tape and large print, contact:
British American Tobacco Publications
Unit 80, London Industrial Park, Roding Road, London E6 6LS
tel: +44 20 7511 7797; facsimile: +44 20 7540 4326
email: bat@team365.co.uk

Alternatively contact Computershare Investor Services (Pty) Ltd using the contact details shown above.

Our website – www.bat.com

Access comprehensive information about British American Tobacco and download shareholder publications at the corporate website; visit the Investor Centre for valuation and charting tools and dividend and share price data and subscribe to the email and SMS alert services for key financial events in the British American Tobacco financial calendar.

Dividend Reinvestment Plan

Available to the majority of shareholders on the UK register, this is a straightforward and economic way of utilising your dividends to build up your shareholding in British American Tobacco. Contact Computershare Investor Services in the UK for details.

Individual Savings Accounts (ISAs)

A British American Tobacco sponsored ISA. Contact:
The Share Centre
PO Box 2000, Aylesbury, Bucks HP21 8ZB
tel: 0800 800 008; +44 1296 414 141
email enquiries: service@share.co.uk
website: www.share.co.uk

(You should note that investments, their value and the income they provide can go down as well as up and you might not get back what you originally invested.)

Capital gains tax

Fact sheet for British American Tobacco historical UK capital gains tax information, contact the British American Tobacco Company Secretarial Department, tel: +44 20 7845 1000 or access the Investor Centre at www.bat.com/investorcentre/cgt

Final dividend 2010 – dates in 2011

24 February	Dividend announced (including amount of dividend per share in both sterling and rand; applicable exchange rate and conversion date)
4 March	Last day to trade (JSE)
7-11 March	No transfers between UK main register and South African branch register, no shares may be dematerialised or rematerialised
7 March	Ex-dividend date (JSE)
9 March	Ex-dividend date (LSE)
11 March	Record date (LSE and JSE)
5 May	Payment date (sterling and rand)

Financial calender 2011

28 April	Interim Management Statement
28 April	Annual General Meeting The Mermaid Conference & Events Centre, London EC4V 3DB
27 July	Half-Yearly Report
26 October	Interim Management Statement

Shareholder and contact information (continued)

Analyses of shareholders

The high and low prices at which the Company's shares are recorded as having traded during the year on each of the LSE and the JSE are as follows:

	High	Low
LSE	£25.21	£19.59
JSE	R272.83	R220.75

At 31 December 2010 there was a total of 2,025,364,622 ordinary shares in issue held by 113,469 shareholders. These shareholdings are analysed as follows:

(a) by listing as at 31 December 2010:

Register	Total number of shares	Percentage of issued share capital	Number of holders
UK	1,778,826,686	87.81	52,772
South Africa	246,929,672	12.19	60,697

(b) by category of shareholder and size of shareholding as at 31 December 2010:

UK Register

Category of UK shareholder	Number of UK holders	Percentage of total UK holders	Number of UK ordinary shares	Percentage of UK ordinary share capital
Individuals	44,230	83.81	55,924,801	3.14
Financial institutions/ Pension funds	307	0.58	10,307,294	0.58
Nominee companies	7,878	14.93	1,664,025,828	93.55
Other corporate holders	356	0.68	19,608,709	1.10
Treasury Shares (UK)	1	<0.01	28,960,054	1.63

South African Register

Category of SA shareholder	Number of SA holders	Percentage of total SA holders	Number of SA ordinary shares	Percentage of SA ordinary share capital
Individuals	44,540	73.38	29,813,754	12.07
Financial institutions/ Pension funds	1,398	2.30	167,682,829	67.91
Nominee companies	12,259	20.20	33,882,246	13.72
Other corporate holders	2,500	4.12	15,550,843	6.30

Combined Registers

Category of shareholder	Number of holders	Percentage of total holders	Number of ordinary shares	Percentage of issued ordinary share capital
Individuals	88,770	78.23	85,738,555	4.23
Financial institutions/ Pension funds	1,705	1.50	177,990,123	8.79
Nominee companies	20,137	17.75	1,697,908,074	83.82
Other corporate holders	2,856	2.52	35,159,552	1.73
Treasury Shares (UK)	1	n/a	28,960,054	1.43

UK Register

	Number of holders	Percentage of UK ordinary share capital
1 – 1,999	43,147	1.25%
2,000 – 9,999	7,498	1.57%
10,000 – 199,999	1,561	3.94%
200,000 – 499,999	222	4.03%
500,000 and over	343	87.58%
Treasury Shares (UK)	1	1.63%

South African Register

	Number of holders	Percentage of SA ordinary share capital
1 – 1,999	53,814	7.96%
2,000 – 9,999	5,147	8.30%
10,000 – 199,999	1,583	24.64%
200,000 – 499,999	88	10.93%
500,000 and over	65	48.17%

Combined Registers

	Number of holders	Percentage of issued ordinary share capital
1 – 1,999	96,961	2.07%
2,000 – 9,999	12,645	2.40%
10,000 – 199,999	3,144	6.46%
200,000 – 499,999	310	4.87%
500,000 and over	408	82.77%
Treasury Shares (UK)	1	1.43%

Registered office
Globe House, 4 Temple Place, London WC2R 2PG
Tel: +44 20 7845 1000, facsimile: +44 20 7240 0555

Incorporated in England and Wales No. 3407696

Secretary
Nicola Snook

General Counsel
Neil Withington

Investor relations
Enquiries should be directed to
Ralph Edmondson, Maya Farhat or Rachael Brierley
tel: +44 20 7845 1180

Press office
Enquiries should be directed to
David Betteridge or Christina Dona
tel: +44 20 7845 2888
email: press_office@bat.com

Auditors
PricewaterhouseCoopers LLP
1 Embankment Place, London WC2N 6RH

British American Tobacco p.l.c. (No. 3407697) Annual Report

This is the Annual Report of the British American Tobacco Group and the Company, comprising the Directors' report and the audited financial statements, for the year ended 31 December 2010. It has been drawn up and is presented in accordance with, and reliance upon, applicable English company law. The liabilities of the Directors in connection with this report shall be subject to the limitations and restrictions provided by such law.

References in this publication to 'British American Tobacco', 'we', 'us', and 'our' when denoting opinion refer to British American Tobacco p.l.c. and when denoting tobacco business activity refer to British American Tobacco Group operating companies, collectively or individually as the case may be.

The Annual Report is published on www.bat.com. A printed copy is mailed to shareholders on the UK main register who have elected to receive it. Otherwise, shareholders are notified that the Annual Report is available on the website and will, at the time of that notification, receive a short Performance Summary (which sets out an overview of the Group's performance, headline facts and figures and key dates in the Company's financial calendar) as well as a Notice of Annual General Meeting and Proxy Form.

Specific local mailing and/or notification requirements will apply to shareholders on the South African branch register.

Cautionary statement

The Business review and certain other sections of the Annual Report contain forward-looking statements which are subject to risk factors associated with, among other things, the economic and business circumstances occurring from time to time in the countries and markets in which the Group operates. It is believed that the expectations reflected in these statements are reasonable but they may be affected by a wide range of variables which could cause actual results to differ materially from those currently anticipated.

Our online Annual Report

To view our Annual Report
online, please visit
www.bat.com/annualreport